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ENERGY EMERGENCY PREPAREDNESS ACT AMENDMENTS OF 1983; AND THE INTERNATIONAL ENERGY AGENCY PROGRAM

HEARING

BEFORE THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 1678

A BILL TO AMEND THE ENERGY POLICY AND CONSERVATION ACT TO STRENGTHEN OUR NATION'S ENERGY EMERGENCY PREPAREDNESS CONSISTENT WITH THE POLICY SET FORTH IN SECTION 271 OF SAID ACT, AND FOR OTHER PURPOSES

AND

THE IEA PROGRAM

OCTOBER 19, 1983

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ENERGY EMERGENCY PREPAREDNESS ACT AMENDMENTS OF 1983; AND THE INTERNATIONAL ENERGY AGENCY PROGRAM

WEDNESDAY, OCTOBER 19, 1983

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, D.C.

The committee met, pursuant to notice, at 10:10 a.m., in room SD-366, Dirksen Office Building, Hon. James A. McClure, chairman, presiding.

Present: Senators McClure, Hecht, Metzenbaum, and Matsunaga.

Also present: Richard D. Grundy, professional staff member; E. David Doane, deputy chief counsel—energy; and James T. Bruce, counsel for the minority.

OPENING STATEMENT OF HON. JAMES A. McCLURE, A U.S. SENATOR FROM THE STATE OF IDAHO

The CHAIRMAN. The committee will come to order. As we've remarked several times already this week, this marks the 10th anniversary of the Arab oil embargo. Just to refresh memories, and we do have short memories sometimes, on October 19, 1973, because of the war in the Middle East and the U.S. participation in it, King Faisal of Saudi Arabia announced an embargo against shipments to the United States that became effective on October 20 and was put into effect on the 22d, 10 years ago. For months after that date we sat in this room drafting legislation to cope with that embargo directed at the United States.

Meanwhile, outside the American consumer was faced with the first indications of an impending shortage which would eventually change the balance of world economic power. Even today, 10 years later, after a tenfold increase in oil prices, we have yet to fully recover from the consequences of that embargo and its impact on the balance of world power.

Many of us are unwilling to allow a repeat of the last 10 years, where those nations who produce oil can, for political reasons, distort the international oil market in such a dramatic fashion as to endanger the economic welfare of the world. The national security implications of another intentional, or even unintentional, international oil shortage are grave. For this reason, among others, the United States continues to support the activities of the International Energy Agency.

Americans have long supported the policy that the Federal Government must be prepared for the possibility of international emergencies affecting national security. The contingency planning efforts of the Department of Defense are widely understood and generally accepted. What is often forgotten, however, is that international oil shortages also affect national security. Moreover, such shortages sap the very economic vitality that is needed for national defense.

Earlier this year I discussed these concerns with the President's National Security Adviser, William Clark, and with Secretary of Energy Hodel. And it is precisely because of our joint concerns that we are here today discussing legislative and administrative steps to strengthen our Nation's energy emergency preparedness. Current national policy, as set forth in section 271 of EPCA, is that:

> The Federal Government shall be prepared prior to any shortage of petroleum products to respond to energy emergencies, pursuant to authorities under provisions of law other than this part, as a supplement to reliance on the free market to mitigate the adverse impacts of a shortage of petroleum products on public health, safety and welfare.

This hearing today is on S. 1678, the Energy Emergency Preparedness Act Amendments of 1983, including a review of U.S. participation in the International Energy Agency. S. 1678 sets forth an understanding reached with the administration on the elements of a compromise on the strategic petroleum reserve and energy emergency preparedness. I will insert in the record the elements of that understanding and related correspondence with the administration.

At this time it is appropriate to note that the agreement deals with: The energy emergency executive reserves; voluntary agreements and plans of action in response to domestic and international energy emergencies; extension until June 30, 1985, of limited antitrust exemption for U.S. oil companies participating in the international energy program; the testing of SPR drawdown, SPR priority performance of contract authority; limited authorization of nondomestic refining of SPR oil; preemption of State price and allocation statutes; authorization of State set-asides; protection of certain private inventories; and reports from the administration on actions to strengthen and improve our Nation's energy emergency preparedness.

Progress has been made during the last year to strengthen the U.S. energy emergency preparedness. Nevertheless, as indicated by the recent participation by the United States in the emergency sharing allocation system test, widely reported and known as AST-4, conducted by the International Energy Agency, there still is room for significant improvement.

Unfortunately, Dr. Ulf Lantzke, Executive Director, International Energy Agency, was not able to be with us today; however, he did furnish a statement that I will place in the record.

Internationally, as was intended, the test pointed out potential weaknesses in the ability of the IEA member countries to respond effectively to a major oil supply disruption; the principal issues raised by AST-4 are set forth in Dr. Lantzke's prepared statement.

Within the United States uncertainty continues to exist regarding what is the chain of policy command in the event of an energy emergency, who has specific operating responsibilities, and what are the specific options that will be considered. This continuing lack of specificity, which the Energy Emergency Preparedness Act of 1982 was intended to correct, creates unacceptable uncertainty. Greater specificity is possible without constraining the President's options. This can be achieved by strengthening the comprehensive energy emergency response procedures. Similarly, we can achieve greater assurance that SPR oil will be utilized to meet the U.S. needs during energy emergencies, and that hoarding and speculation with SPR oil is prevented. This can be achieved by establishment of appropriate terms and conditions of sale as a part of the "standard" sales contract. In addition, special circumstances can be addressed by directed sale of SPR oil.

These and other improvements are needed to assure that we, as a nation, are prepared to effectively cope with the consequences of another international oil shortage, an event which I am convinced will occur.

[The materials inserted by Chairman McClure follow:]

By Mr. McCLURE:

S. 1678. A bill to amend the Energy Policy and Conservation Act to strengthen our Nation's energy emergency preparedness consistent with the policy set forth in section 271 of said act, and for other purposes; to the Committee on Energy and Natural Resources.

ENERGY EMERGENCY PREPAREDNESS ACT AMENDMENTS OF 1983

● Mr. McCLURE. Mr. President, as a nation the United States has long accepted the fact that it should be prepared for the possibility of emergencies affecting national security. The contingency planning efforts of the Department of Defense are widely understood and accepted.

Energy emergencies also affect national security. This was dramatically demonstrated—not only in 1973—but in 1978 and 1979 when a marginal shift in world oil supplies resulted in a doubling of oil prices. Many of us believe that we dare not allow ourselves to be put in the same position again; a position that we have found ourselves in twice during the last 10 years; a position where those who produce oil overseas for political reasons—not economic reasons—can distort the market in such a dramatic fashion as to endanger the welfare of not just the United States, but the world.

I am certain these occurrences were not good for the American economy; and I am absolutely positive they were threatening to our national security. The implications of a repeat of this experience are of critical importance for the security of the American people.

Mr. President, earlier this year I discussed these concerns with the President's National Security Adviser, William Clark, and with Secretary of Energy Donald Paul Hodel. And it is precisely because of these concerns that last year the Congress and the administration jointly formulated the Energy Emergency Preparedness Act of 1982 which set forth as national policy that:

> The Federal government shall be prepared prior to any shortage of petroleum products to respond to energy emergencies pursuant to authorities under provisions of law other than this part, as a supplement to reliance on the free market to mitigate the adverse impacts of a shortage of petroleum products on public health, safety, and welfare (Sec. 271(b)).

The Energy Emergency Preparedness Act of 1982 authorized a series of actions by the Department of Energy to upgrade the status of the U.S. energy emergency preparedness to respond to a severe oil supply interruption, an interruption sufficiently large enough to cause severe economic dislocations and hardships, or constitute serious threat to public health, safety, and welfare.

Consequently considerable progress has been made during the last year to improve the U.S. energy emergency preparedness; yet we are still not adequately prepared. Recent, and ongoing, tests and exercises by the Department of Energy have documented areas for improvement in the U.S. energy emergency response capability. Some of the areas of improvement were recently outlined in Secretary of Energy Donald Paul Hodel's letter of July 19, 1983. That letter was part of a two-part agreement negotiated with the administration to save approximately $1 billion annually while insuring that the United States will be more fully prepared for an international oil supply interruption. The other part of the agreement, which is set forth in a letter from OMB Director David Stockman, will assure completion of the strategic petroleum reserve.

The agreement will, first, provide a strong multiyear commitment to completion of the strategic petroleum reserve to the full 750 million barrels approved by the Congress and, second, support for the necessary administrative and legislative actions to insure full implementation, in a timely fashion, of the current energy emergency preparedness policy established by the Energy Emergency Preparedness Act of 1982.

Mr. President, the Congress and the administration share a strong commitment to the strategic petroleum reserve as part of our Nation's energy emergency preparedness efforts. The initiatives in letters from OMB David A. Stockman and from Secretary of Energy Donald Paul Hodel reflect the determination of the administration and the Congress that the United States maintain and improve its defense and national security positions in the event of petroleum supply interruptions.

The agreement includes a multiyear programmatic commitment by the administration to completion of the strategic petroleum reserve to the congressionally mandated level of 750 million barrels. The agreement also endorses maintenance of an annual fill rate of approximately 145,000 barrels per day through fiscal year 1988. This will insure a continuous, predictable, and relatively level and constant filling of the reserve to full capacity, as the construction of permanent storage facilities proceeds. Significant budget savings of approximately $769 million in fiscal year 1984 and $972 million in fiscal year 1985 will result from more realistic fill rates in the near term.

In addition, construction of additional major permanent storage facilities can proceed at a fairly constant and predictable pace which reflects fiscal and national security considerations. Under the agreement, the Big Hill facility will begin construction by mid-fiscal year 1985.

This construction schedule and fill rate will avoid the use of interim storage facilities, thus keeping storage costs to a minimum. This construction schedule and fill rate also will enable the strategic petroleum reserve to provide approximately a constant level of protection of the American economy in the event of a petroleum disruption. Under the agreement in 1985 the United States will have the ability to replace all imports with SPR oil for 73 days compared to 82 days supply—or 9 days more of supply—under a fill rate of 220,000 barrels per day. And the difference in cumulative fill at the end of fiscal year 1984 will be only 27 million barrels, or 6 percent.

Under existing economic circumstances and improvement in conservation and efficiency in the use of energy in the United States current import levels are markedly reduced. The world oil market is dramatically changed for the better since establishment of the strategic petroleum reserve. Instead of importing 11 million barrels per day in 1985 as projected in 1977, recent Department of Energy forecasts project U.S. imports at only 6.1 million barrels per day; this represents a 45-percent reduction from those earlier forecasts. As a consequence the United States will be provided 73 days of protection instead of the 60 days that would have been provided based upon projections made as recently as 1980.

Moreover, the OPEC share of U.S. oil imports has declined from a peak of 70 percent in 1977 to 30 percent in 1983. Concurrently the share of imports from Arab OPEC countries has declined from 37 percent in 1977 to 10 percent in 1983. The decline in volumes of Arab OPEC oil imports is even more dramatic; imports in 1983 will be 350,000 barrels per day compared to a 1977 peak of 3.2 million barrels per day.

Thus the possibility exists to reduce the Federal budget deficit by the stretch-out of the strategic petroleum reserve outlined without a threat to the health of our economy and national security.

This agreement, Mr. President, is representative of the great and significant potential that exists for cooperation between the Reagan administration and the Congress; working together we can achieve the dual purpose of urgently needed Federal budget savings while advancing policies and programs which are critical to our Nation's economic and national security.

Mr. President, I ask unanimous consent that a summary of this agreement regarding the strategic petroleum reserve and energy emergency preparedness appear at this point in my remarks.

There being no objection, the summary was ordered printed in the Record, as follows:

Elements of Agreement on Strategic Petroleum Reserve and Energy Emergency Preparedness

The agreement includes the following elements to strengthen our Nation's energy emergency preparedness which are outlined in Secretary Hodel's letter of July 19, 1983 to Chairman McClure:

(1) legislation to assure legally the availability and effectiveness of the Executive Manpower Reserves in domestic and international energy emergencies in order to meet both defense-related and non-defense-related needs;

(2) extension of Section 252 of the Energy Policy and Conservation Act (EPCA), pertaining to the International Energy Agency antitrust defense, to coincide with the EPCA expiration date of June 30, 1985;

(3) identification and Administration support for legislation to correct shortfalls in existing emergency preparedness legislation, such as current provisions which require clarification or which contain inconsistencies which may impede proper implementation of the current energy emergency preparedness policies established in Section 271 of the EPCA;

(4) appropriate legal resolution to protect against the possibility that States or local governments may, by the adoption of price and allocation laws, interfere in the domestic marketplace and thereby worsen energy emergencies, so as to preserve the ability of the domestic marketplace to work effectively in the event of a severe petroleum supply disruption;

(5) appropriate administrative action on a timely basis to continue an effort to improve and to upgrade the Comprehensive Energy Emergency Response Procedures contemplated by the Energy Emergency Preparedness Act of 1982 so as to assure achievement of the preparedness policies and purposes of Section 271 of EPCA, including a continuing effort to determine, in light of results of ongoing tests and exercises, the improvements which may be needed in the areas of internal Department of Energy organization, inter-agency coordination, decision-making procedures and emergency alert systems and logistics support; and

(6) administrative actions, commensurate with the existing SPR drawdown plan and other presently effective, associated legal authorities with a view to development of measures necessary (a) to assure that the SPR will be applied to meet domestic needs, including regional hardships, and foreign obligations, including those under the International Energy Agency and NATO agreements, and (b) to assure that SPR oil, including any SPR oil distributed by directed sales, enters the market during the emergency and will be protected against speculation and hoarding.

The agreement includes the following elements which form a commitment to completion of the Strategic Petroleum Reserve which are set forth in OMB Director Stockman's letter of July 19, 1983:

(1) development of the full 750 million barrel reserve by the end of fiscal year 1991;

(2) requesting funds for major construction at Big Hill in the budget for fiscal year 1985 that will be submitted to Congress next January;

(3) requesting funds for oil acquisition sufficient to maintain a fill rate over the 1984-88 period of at least 145,000 barrels per day, with some necessary year-to-year flexibility to accommodate especially favorable purchases that may arise in the future; and,

(4) completion of Big Hill on a schedule that will allow fill of the facility to begin no later than the third quarter of fiscal year 1987.

Mr. McCLURE. Mr. President, at this time I wish to introduce the Energy Emergency Preparedness Act Amendments of 1983. This measure would provide for implementation of the agreement with the administration on the strategic petroleum reserve and energy emergency preparedness. The measure would support those administrative initiatives which OMB Director Stockman and Secretary Hodel have indicated the executive branch is prepared to undertake. The bill also would provide those additional authorities which are necessary to fully implement the policy set forth in section 271(b) of the Energy Emergency Preparedness Act of 1982, which I enunciated earlier.

Mr. President, I ask unanimous consent that the text of the bill and the relevant letters of July 19, 1983, from OMB Director David Stockman and Secretary of Energy Donald Paul Hodel be reprinted following these remarks.

II

98TH CONGRESS
1ST SESSION

S. 1678

To amend the Energy Policy and Conservation Act to strengthen our Nation's energy emergency preparedness consistent with the policy set forth in section 271 of said Act, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JULY 25, 1983

Mr. MCCLURE introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To amend the Energy Policy and Conservation Act to strengthen our Nation's energy emergency preparedness consistent with the policy set forth in section 271 of said Act, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Energy Emergency Preparedness Act Amendments of 1983".

(b) TABLE OF CONTENTS.—

Sec. 1. Short title; table of contents.
Sec. 2. Congressional findings and purposes.
Sec. 3. Energy emergency preparedness organizations: executive reserves, and voluntary agreements and plans of action.

Sec. 4. International energy program amendments.
Sec. 5. Strategic Petroleum Reserve amendments.
Sec. 6. Effect on State laws.
Sec. 7. Report to the Congress.

SEC. 2. FINDINGS AND PURPOSES.

(a) FINDINGS.—The Congress finds that—

(1) legislative and administrative actions are needed to strengthen and improve our Nation's energy emergency preparedness in order to implement fully section 271 of the Energy Policy and Conservation Act (42 U.S.C. 6281), which established the policy that the Federal Government shall be prepared prior to any shortage of petroleum products to respond to energy emergencies, as a supplement to reliance on the free market to mitigate the adverse impacts of a shortage of petroleum products on public health, safety, and welfare; and

(2) individual State and local pricing and allocation of petroleum could frustrate free market price and allocation of available petroleum supplies, and the response of the Federal Government to energy emergencies.

(b) PURPOSE.—The purpose of this Act is to further carry out the policy set forth in section 271(b) of the Energy Policy and Conservation Act (42 U.S.C. 6281(b))—

(1) amending existing energy emergency authorities to—

(A) assure that such authorities are adequate for, and remove any inconsistencies which may impede, proper implementation of the energy emergency preparedness policy established by section 271(b) of the Energy Policy and Conservation Act (42 U.S.C. 6281(b));

(B) assure the availability and effectiveness of organizations for utilizing the assistance of the private sector, including the energy emergency executive reserves, and voluntary agreements and plans of action, in domestic and international energy emergencies in order to meet both defense-related and non-defense-related needs;

(C) extend the expiration date of section 252(j) of the Energy Policy and Conservation Act (42 U.S.C. 6272(j)) to June 30, 1985; and

(D) preserve the ability of the domestic marketplace to work effectively in the event of a severe petroleum supply disruption by protecting against the possibility that States or local governments may, by the adoption of price and allocation laws, interfere in the domestic marketplace and thereby worsen energy emergencies;

(2) undertaking appropriate administrative actions to—

(A) improve and upgrade, on a timely basis, the comprehensive energy emergency response procedures provided for the Energy Emergency Preparedness Act of 1982, by incorporating improvements that are needed in light of the results of ongoing tests and exercises relating to the energy emergency response capabilities of the United States; and

(B) assure, commensurate with the Strategic Petroleum Reserve distribution plan and with existing legal authorities, that—

(i) the Strategic Petroleum Reserve will be applied to meet domestic needs, including regional hardships, and can be applied to meet international obligations of the United States (including those under the International Energy Agency and NATO agreements); and

(ii) petroleum products from the Strategic Petroleum Reserve, including any such petroleum products distributed by directed sales, enter the market during the energy emergency and are protected from speculation and hoarding; and

(3) completing the Strategic Petroleum Reserve by—

(A) developing a seven hundred and fifty million barrel reserve by the end of fiscal year 1991;

(B) maintaining an average annual fill rate over the fiscal years 1984 through 1988 of at least one hundred and forty-five thousand barrels per day, with some necessary year-to-year flexibility to accommodate expecially favorable purchases that may arise in the future; and

(C) completing the Big Hill facility on a schedule that will allow fill of the facility to begin no later than the third quarter of fiscal year 1987.

SEC. 3. ENERGY EMERGENCY PREPAREDNESS ORGANIZATIONS: EXECUTIVE RESERVES, AND VOLUNTARY AGREEMENTS AND PLANS OF ACTION.

(a) Part C of title II of the Energy Policy and Conservation Act (42 U.S.C. 6281), relating to energy emergency preparedness, is amended by adding at the end thereof the following new subsections:

"ENERGY EMERGENCY EXECUTIVE RESERVES

"SEC. 273. EMPLOYMENT OF PERSONNEL; APPOINTMENT POLICIES; AND EXECUTIVE RESERVES.—(a)(1) The President is authorized, to the extent he deems it necessary and appropriate in order to implement the comprehensive energy emergency response procedures provided for in section 272(b), and subject to such regulations as he may issue, to employ persons of outstanding experience and ability without compensation in connection with the activities of the Emergency Petroleum and Gas Executive Reserve, the Emergency Solid Fuels Executive Reserve, and the Emergency Electric Power Executive Reserve of the Department of Energy.

"(2) The President shall be guided in the exercise of the authority provided in this subsection by the following policies:

"(A) So far as possible, operations to carry out the provisions of this part shall be carried on by full-time, salaried employees of the Federal Government, and appointments under this authority shall be to advisory or consultative positions only.

"(B) Appointments to positions other than advisory or consultative may be made under this authority only when the requirements of the position are such that the incumbent must personally possess outstanding experience and ability not obtainable on a full-time, salaried basis.

"(C) In the appointment of personnel and in assignment of their duties, the President shall take steps to avoid, to as great an extent as possible, any conflict between the governmental duties and the private interests of such personnel.

"(3) Appointees under this subsection shall, when policy matters are involved, be limited to advising appropriate full-time salaried Federal Government officials who are responsible for making policy decisions.

"(4) Notwithstanding any other provision of law, the President, upon finding that the national interest requires such action, may exempt persons who become employed pursuant to paragraph (1) from the operation of—

"(A) all Federal laws pertaining to conflict of interest including, but not limited to—

"(i) sections 202 through 209 of title 18, United States Code;

"(ii) sections 201 through 211 of title 5, United States Code, appendix I; and

"(iii) sections 601 through 608 of the Department of Energy Organization Act (42 U.S.C. 7211–7218); and

"(B) the antitrust laws (as defined in section 3(9)).

"(5) Appointments under this subsection shall be supported by written certification by the Secretary of Energy that—

"(A) the appointment is necessary and appropriate in order to implement the Comprehensive Energy Emergency Response Procedures;

"(B) the duties of the position to which the appointment is being made require outstanding experience and ability; and

"(C) the appointee has the outstanding experience and ability required by the position.

"(6) The Secretary of Energy shall publish in the Federal Register a statement including the name of the appointee, the title of his position, and the name of his private employer. The appointee shall file with the Secretary of Energy a statement listing the names of any corporations of which he is an officer or director or within 60 days preceding his appointment has been an officer or director, or in which he owns, or within 60 days preceding his appointment has owned, any stocks, bonds, or other financial interests, and the names of any partnerships in which he is, or was within 60 days preceding his appointment, a partner, and the names of any other businesses in which he owns, or within such 60-day period has owned, any similar interest. At the end of each succeeding 6-month period, the appointee shall file with the Secretary a statement showing any changes in such interests during such period.

"(7) At least once every 3 months the Director of the Office of Personnel Management shall survey appointments made under this subsection and shall report his findings to the President and the Congress and make such recommendations as he may deem proper.

"(8) Persons appointed under the authority of this subsection may be allowed transportation and per diem in lieu of subsistence while away from their homes or regular places of business pursuant to such appointment, in accordance with title 5 of the United States Code.

"(b) The President may utilize the services of Federal, State, and local agencies and may utilize and establish such regional, local, or other agencies, and utilize such voluntary or uncompensated services from them, as may from time to time be needed to implement this section; and he is authorized to provide by regulation for the exemption of persons whose services are utilized under this subsection from the operation of—

"(1) all Federal laws pertaining to conflict of interest including, but not limited to—

"(A) sections 202 through 209 of title 18, United States Code;

"(B) sections 201 through 211 of title 5, United States Code, appendix I; and

"(C) sections 601 through 608 of the Department of Energy Organization Act (42 U.S.C. 7211–7218); and

"(2) the antitrust laws (as defined in section 3(9)).

"(c)(1) The President is further authorized to provide for the establishment and training of the Emergency Petroleum and Gas Executive Reserve, the Emergency Solid Fuels Executive Reserve, and the Emergency Electric Power Executive Reserve for employment in executive positions in the Federal Government to assist in implementing the Comprehensive Energy Emergency Response Procedures provided for in section 272(b). Members of these executive reserves who are not full-time Federal Government employees may be allowed transportation and per diem in lieu of subsistence, in accordance with title 5 of the United States Code (with respect to individuals serving without pay, while away from their homes or regular places of business), for the purpose of participating in the executive reserve training program. Notwithstanding any other provision of law, the President, upon finding that the national interest requires such action, may exempt members of these executive reserves who become employed by the Federal Government during or in preparation for periods of domestic or international energy emergency, or who are engaged in the executive reserve training program, from the operation of—

"(A) all Federal laws pertaining to conflict of interest including, but not limited to:

"(i) sections 202 through 209 of title 18, United States Code;

"(ii) sections 201 through 211 of title 5, United States Code, appendix I; and

"(iii) sections 601 through 608 of the Department of Energy Organization Act (42 U.S.C. 7211–7218); and

"(B) the antitrust laws (as defined in section 3(9)).

"(2) The Secretary of Energy shall publish in the Federal Register a statement including the name of a member of these executive reserves who has become employed by the Federal Government, the title of his position, and the name of his private employer. The employee shall file with the Secretary of Energy a statement listing the names of any corporations of which he is an officer or director or within 60 days preceding his employment has been an officer or director, or in which he owns, or within 60 days preceding his employment has owned, any stocks, bonds, or other financial interests, and the names of any partnerships in which he is, or was within 60 days preceding his employment, a partner, and the names of any other businesses in which he owns, or within such 60-day period has owned, any similar interest. At the end of each succeeding 6-month period, the employee shall file with the Secretary a statement showing any changes in such interests during such period.

"(d) Notwithstanding any other provision of law, personnel used under this section, including persons employed without compensation, the executive reserves and any members of the executive reserves who become employed by the Federal Government during or in preparation for periods of domestic or international energy emergency, or who are engaged in the executive reserve training programs, are exempt from the operation of all Federal laws, rules, and regulations pertaining to advisory committees.

"VOLUNTARY AGREEMENTS AND PLANS OF ACTION FOR ENERGY EMERGENCIES

"SEC. 274. (a) The President is authorized to consult with representatives of the energy industry, energy consumers, and other interests, with a view to encouraging the making by such persons of voluntary agreements and plans of action which would be in the public interest and contribute to the objectives of this part by facilitating preparation for, or a response to, a domestic or international energy emergency.

"(b) The President shall prescribe standards and procedures by which persons may develop and carry out voluntary agreements and plans of action provided for in subsection (a).

"(c) The standards and procedures prescribed under subsection (b) shall include the following requirements:

"(1)(A) Except as provided in subparagraph (B), meetings held to develop or carry out a voluntary agreement or plan of action under this section shall—

"(i) permit attendance by representatives of committees of the Congress and interested persons, including all interested segments of the energy industry, energy consumers, and the public;

"(ii) be preceded by timely and adequate notice with identification of the agenda of such meeting to the Attorney General, the Federal Trade Commission, committees of the Congress, and (except during an energy emergency with respect to meetings to carry out a voluntary agreement or to develop or carry out a plan of action) the public; and

"(iii) be initiated and chaired by a regular full-time employee of the Department of Energy.

"(B) The President may determine that a meeting held to carry out a voluntary agreement or to develop or carry out a plan of action shall not be open to interested persons or that attendance by interested persons may be limited, if the President finds that a wider disclosure would be detrimental to the interests of the United States.

"(C) No meetings may be held to develop or carry out a voluntary agreement or plan of action under this section unless a regular full-time employee of the Department of Energy is present.

"(2) Interested persons permitted to attend such a meeting shall be afforded an opportunity to present, in writing and orally, data, views, and arguments at such meetings, subject to any reasonable limitations with respect to the manner of presentation of data, views, and arguments as the Secretary of Energy may impose.

"(3) A full and complete record, and where practicable a verbatim transcript, shall be kept of any meeting held, and a full and complete record shall be kept of any communication (other than in a meeting) made, between or among participants or potential participants, to develop or carry out a voluntary agreement or a plan of action under this section. Such record or transcript shall be deposited, together with any agreement resulting therefrom, with the Secretary of Energy and shall be available to the Attorney General and the Federal Trade Commission. Such records or transcripts shall be available for public inspection and copying in accordance with section 552 of title 5, United States Code; except that (A) matter may not be withheld from disclosure under section 552(b) of such title on grounds other than the grounds specified in section 552(b)(1), (b)(3), or so much of (b)(4) as relates to trade secrets; and (B) in the exercise of authority under section 552(b)(1), the President shall consult with the Secretary of State and the Attorney General with respect to questions relating to the foreign policy interests of the United States.

"(4) No provision of this section may be implemented so as to prevent representatives of committees of Congress from attending meetings to which this section applies, or from having access to any transcripts, records, and agreements kept or made under this section. Such access to any transcript that is required to be kept for any meeting shall be provided as soon as practicable (but not later than 14 days) after that meeting.

"(d)(1) The Attorney General and the Federal Trade Commission shall participate from the beginning in the development, and when practicable, in the carrying out of voluntary agreements and plans of action authorized under this section. Each may propose any alternative which would avoid or overcome, to the greatest extent practicable, possible anticompetitive effects while achieving substantially the purposes of this part. A voluntary agreement or plan of action under this section may not be carried out unless approved by the Secretary of Energy and by the Attorney General, after consultation with the Federal Trade Commission. Prior to the expiration of the period determined under paragraph (2), the Federal Trade Commission shall transmit to the Attorney General its views as to whether such an agreement or plan of action should be approved, and shall publish such views in the Federal Register. The Attorney General, in consultation with the Federal Trade Commission and the Secretary of Energy, shall have the right to review, amend, modify, disapprove, or revoke, on his own motion or upon the request of the Federal Trade Commission or any interested person, any voluntary agreement or plan of action at any time, and, if revoked, thereby withdraw prospectively any immunity which may be conferred by subsection (f) or (i).

"(2) Any voluntary agreement or plan of action entered into pursuant to this section shall be submitted in writing to the Attorney General and the Federal Trade Commission at least 20 days before being implemented; except that during a domestic or international energy emergency found by the President to exist, the Secretary of Energy, subject to approval of the Attorney General, may reduce such 20-day period. Any such agreement or plan of action shall be available for public inspection and copying, except that a plan of action shall be so available only to the extent to which records or transcripts are so available as provided in the last sentence of subsection (c)(3). Any action taken pursuant to such voluntary agreement or plan of action shall be reported to the Attorney General and the Federal Trade Commission pursuant to such regulations as may be prescribed under subsections (e) (3) and (4).

"(3) A plan of action may not be approved by the Attorney General under this subsection unless such plan—

"(A) describes the types of substantive actions which may be taken under the plan, and

"(B) is as specific in its description of proposed substantive actions as is reasonable in light of circumstances known at the time of approval.

"(e)(1) The Attorney General and the Federal Trade Commission shall monitor the development and carrying out of voluntary agreements and plans of action authorized under this section in order to promote competition and to prevent anticompetitive practices and effects, while achieving substantially the purposes of this part.

"(2) In addition to any requirement specified under subsections (b) and (c) of this section and in order to carry out the purposes of this section, the Attorney General, in consultation with the Federal Trade Commission and the Secretary of Energy, may promulgate rules concerning the maintenance of necessary and appropriate records related to the development and carrying out of voluntary agreements and plans of action authorized pursuant to this section.

"(3) Persons developing or carrying out voluntary agreements and plans of action authorized pursuant to this section shall maintain such records as are required by rules promulgated under paragraph (2). The Attorney General and the Federal Trade Commission shall have access to and the right to copy such records at reasonable times and upon reasonable notice.

"(4) The Attorney General and the Federal Trade Commission may each prescribe such rules as may be necessary or appropriate to carry out their respective responsibilities under this section. They may both utilize for such purposes and for purposes of enforcement any powers conferred upon the Federal Trade Commission or the Department of Justice, or both, by the antitrust laws or the Antitrust Civil Process Act; and wherever any such law refers to 'the purposes of this Act' or like terms, the reference shall be understood to include this section.

"(f)(1) There shall be available as a defense to any civil or criminal action brought under the antitrust laws (as defined in section 3(9)) in respect to actions taken to develop or carry out a voluntary agreement or plan of action (provided that such actions were not taken for the purpose of injuring competition) that—

"(A) such actions were taken—

"(i) in the course of developing a voluntary agreement or plan of action pursuant to this section, or

"(ii) to carry out a voluntary agreement or plan of action authorized and approved in accordance with this section, and

"(B) the persons taking such actions complied with the requirements of this section and the rules promulgated hereunder.

"(2) Except in the case of actions taken to develop a voluntary agreement or plan of action, the defense provided in this subsection shall be available only if the person asserting the defense demonstrates that the actions were described in, or within the reasonable contemplation of an approved voluntary agreement or plan of action.

"(g) No provision of this section shall be construed as granting immunity for, or as limiting or in any way affecting any remedy or penalty which may result from any legal action or proceeding arising from, any act or practice which occurred prior to the date of enactment of this section or subsequent to its expiration or repeal.

"(h) The Attorney General and the Federal Trade Commission shall each submit to the Congress and to the President, at least once annually, a report on the impact on competition and on small business of actions authorized by this section.

"(i) In any action in any Federal or State court for breach of contract, there shall be available as a defense that the alleged breach of contract was caused predominantly by action taken during a domestic or international energy emergency found by the President to exist, to carry out a plan of action authorized and approved in accordance with this section.

"(j) Notwithstanding any other provision of law, participants in voluntary agreements or plans of action, when acting in compliance with the requirements of this section, the rules promulgated hereunder, and the provisions of the voluntary agreement or plan of action, are exempt from the operation of all Federal laws, rules, and regulations pertaining to advisory committees.

"(k) The authority provided by this section shall not apply to the development or carrying out of voluntary agreements or plans of action to implement the allocation and information provisions of the international energy program.

(b) Conforming Amendments.—Section 271 of the Energy Policy and Conservation Act (42 U.S.C. 6281) is amended—

(1) in subsection (b), by deleting "other than this part" and inserting in lieu thereof, "other than section 272".

(2) in subsection (c), by deleting "other than this part" and inserting in lieu thereof, "other than section 272, and by making available to the President authorities for utilizing the private sector in implementing this policy".

(c) The table of contents of the Energy Policy and Conservation Act is amended further by inserting after the item relating to section 272 the following:

"Sec. 273. Energy emergency executive reserves.
"Sec. 274. Voluntary agreements and plans of action for energy emergencies.".

SEC. 4. INTERNATIONAL ENERGY PROGRAM AMENDMENTS.

(a) EXTENSION.—Subsection (j) of section 252 of the Energy Policy and Conservation Act (42 U.S.C. 6272(j)) is amended by striking out "December 31, 1983" and inserting in lieu thereof "June 30, 1985".

(b) OTHER AMENDMENTS.—Section 252 of the Energy Policy and Conservation Act (42 U.S.C. 6272) is amended—

(1) in subsection (d)(3), by deleting "known circumstances" and inserting in lieu thereof, "circumstances known at the time of approval";

(2) in subsection (e)(2), by deleting "shall" and inserting in lieu thereof, "may";

(3) in subsection (f)(2), by inserting after "approved", the phrase "voluntary agreement or"; and

(4) in subsection (i), by deleting "once every 6 months" and inserting in lieu thereof "annually".

SEC. 5. STRATEGIC PETROLEUM RESERVE AMENDMENTS.

(a) CONFORMING AMENDMENTS.—Section 160 of the Energy Policy and Conservation Act (42 U.S.C. 6240) is amended—

(1) in subsection (c)(1)(A), by striking "500,000,000" and inserting in lieu thereof "750,000,000";

(2) by striking subsections (c)(1)(B) and (C), and inserting in lieu thereof the following:

"(B) The minimum required fill rate shall be 145,000 barrels per day for the purposes of subparagraph (A).";

(3) by redesignating subsection (c)(1)(D) as subsection (c)(1)(C);

(4) in redesignated subsection (c)(1)(C), deleting "(C)" and inserting in lieu thereof "(B)"; and

(5) in subsection (c)(2), by striking "300,000" and inserting in lieu "145,000".

(b) CLARIFYING AMENDMENTS.—Section 161 of the Energy Policy and Conservation Act (42 U.S.C. 6241) is amended by adding the following new subsections:

"(g) Nothing in this part shall be construed to limit the authority of the Secretary of Energy to conduct sales of petroleum products stored in the Strategic Petroleum Reserve for the purposes of testing drawdown and distribution of the Reserve; such sales shall not be considered to be drawdown and distribution under this section.

"(h) The President is hereby authorized to require that performance under any contracts or orders (other than contracts of employment) which he deems necessary or appropriate to implement drawdown and distribution of the Strategic Petroleum Reserve, including service contracts, shall take priority over performance under any other contract or order, except a conflicting contract or order issued pursuant to section 101(a) of the Defense Production Act (50 U.S.C. App. 2071(a)), and for the purpose of assuring the priority transportation of Reserve petroleum products during drawdown and distribution, to require acceptance and performance of such contracts or orders in preference to other contracts or orders by any person he finds is capable of their performance or could be made capable without an unreasonable change in that person's normal business practices.

"(i) Notwithstanding any other provision of law, the President may permit any crude oil withdrawn from the Strategic Petroleum Reserve in accordance with the provisions of this section to be exported to any country pursuant to an arrangement for the delivery of refined petroleum products to the United States.”.

SEC. 6. EFFECT ON STATE LAWS.

(a) Part C of title II of the Energy Policy and Conservation Act, relating to energy emergency preparedness, is further amended by adding at the end thereof the following new section:

“EFFECT ON STATE LAWS

“Sec. 275. (a) Preemption.—(1) Except as provided in paragraph (2) and subsection (b), any law or regulation adopted or promulgated by a State or any political subdivision thereof, to the extent that such law or regulation provides for the pricing or allocation of residual fuel oil or any other petroleum product, is hereby preempted.

“(2) The President may, by rule or order, exempt from the operation of paragraph (1) classes or categories of laws or regulations, or specific laws or regulations, which would otherwise be preempted under paragraph (1), to the extent that the President determines that such laws or regulations would—

“(A) preserve a significant State or local interest;

“(B) not unduly burden interstate commerce; and

“(C) not interfere with the policy established by section 271.

"(b) STATE SET-ASIDE.—The Governor of any State may notify the President of the Governor's intent to implement, under State law and in accordance with the requirements of this subsection, a State set-aside program for residual fuel oil or any other refined petroleum product.

"(2) For purposes of this subsection, the term 'State set-aside program' means with respect to residual fuel oil or any other refined petroleum product, a program administered by the State under State law and which—

"(A) is implemented only upon a determination by the Governor that the program is required to meet a petroleum supply shortage within the State which will significantly impair essential public services or essential economic activity;

"(B) continues in effect for no more than 90 days;

"(C) authorizes the Governor to require a prime supplier of residual fuel oil or any other refined petroleum product subject to the program to set aside in any month a volume of such residual fuel oil or other refined petroleum product for distribution under the program which volume does not exceed 5 percent of the total supply, as estimated by such supplier, of such residual fuel oil or other refined petroleum product which will be sold by the supplier in the State for consumption within the State in that month;

"(D) defines a prime supplier as a supplier which makes the first sale of that residual fuel oil or other refined petroleum product subject to the State set-aside into the State distribution system for consumption within the State; and

"(E) does not unduly burden interstate commerce.

"(3)(A) The Governor shall provide the President with notice under paragraph (1), accompanied by a request for approval of the State set-aside program the Governor intends to implement, at least 10 days prior to the date on which the Governor intends to implement the program.

"(B) Within 10 days after receipt of such notice and request transmitted by the Governor, the President shall, in his discretion, either approve or disapprove such request and notify the Governor of the President's action.

"(C) To the extent that the President approves the request within such 10-day period, the program shall then be exempt from the operation of subsection (a).

"(D) If the President does not approve such request within such 10-day period, the request shall be considered disapproved and the program shall not be exempt under this subsection from the operation of subsection (a).

"(E) The President's approval of any program under this subsection may be in whole or in part; but only so much of any State set-aside program as the President approves under this paragraph may be implemented.

"(4) Notwithstanding the 90-day limitation in paragraph (2)(B), an exemption under this subsection allowing implementation of any State set-aside program may be extended by the President for successive 90-day periods if the Governor transmits a notice and request therefor to the President and the President approves such request prior to the expiration of the applicable 90-day period. For such purposes, the preceding provisions of this subsection shall apply with respect to any notice and request for such an extension as if it were for exemption for initial implementation.

"(5) Any approval or disapproval by the President of a request under paragraph (3) shall not be subject to judicial review.

"(c) PROTECTION OF CERTAIN INVENTORIES.—(1) Notwithstanding subsection (b), no State shall have authority to—

"(A) provide for the allocation of consumer petroleum inventories,

"(B) impose restrictions on the consumption of such inventories, or

"(C) consider or take into account the existence or size of such inventories in determining the amount of petroleum products to be allocated to any such consumer.

"(2) For purposes of paragraph (1)—

"(A) The term 'consumer petroleum inventory' means an inventory of residual fuel oil or other refined petroleum products which is—

"(i) held by and in the custody of a consumer (other than a refiner, except to the extent provided in subparagraph (C)) for such consumer's own end-use consumption,

"(ii) held by and in the custody of such consumer on the day before the date on which a State set aside program is implemented, and

"(iii) not thereafter sold by such consumer, but only to the extent that such inventory does not exceed the inventory of residual fuel oil and refined petroleum products held by and in the custody of that consumer for its own end-use consumption on the 30th day prior to the date of such implementation.

"(B) The term 'held by and in the custody of', when used with respect to an inventory, means any such inventory owned by the consumer and in the direct possession of the consumer, such as on the consumer's site.

"(C) The term 'end-use consumption', in the case of an inventory of residual fuel oil or other refined petroleum products of any consumer which is a refiner, means the use by the refiner of such residual fuel oil or other refined petroleum products to meet normal fuel requirements necessary for operating refinery equipment and facilities.".

(b) CONFORMING AMENDMENTS.—Section 271 of the Energy Policy and Conservation Act is amended—

(1) in subsection (a)(2), by deleting "and";

(2) in subsection (a)(3), by deleting the period and inserting in lieu thereof a semicolon and the word "and";

(3) in subsection (a), by adding the following new paragraph:

"(4) individual State and local pricing or allocation of petroleum could frustrate free market pricing and allocation of available petroleum supplies, and the response of the Federal Government to energy emergencies."; and

(4) in subsection (c), by inserting after, "than this part", a semicolon and "further, by preventing individual State and local petroleum pricing or allocation laws or regulations from interfering with the carrying out of this policy.".

(c) The table of contents of the Energy Policy and Conservation Act is amended by inserting after the new item relating to section 274 the following:

"Sec. 275. Effect on State laws.".

SEC. 7. REPORT TO THE CONGRESS.

(a) The Energy Emergency Preparedness Act of 1982 is amended by adding at the end thereof the following new section:

"SEC. 7. REPORT TO THE CONGRESS.

"(a) The Secretary of Energy shall undertake, pursuant to authorities otherwise available under existing law, additional actions necessary to strengthen and improve our Nation's energy emergency preparedness in order to implement fully the policy established by section 271(b) of the Energy Policy and Conservation Act (42 U.S.C. 6281(b)). The Secretary shall report, as specified in subsection (6), to the Congress on any such actions taken, including, but not limited to, measures to—

"(1) improve and upgrade on a timely basis, the comprehensive energy emergency response procedures provided for by section 272(b) of the Energy Emergency Preparedness Act of 1982 (42 U.S.C. 6282(b)) by incorporating improvements (including improvements in Department of Energy organization, interagency coordination, decisionmaking procedures, and emergency alert systems and logistics support) that are needed in light of the results of ongoing tests and exercises relating to the energy emergency response capability of the United States;

"(2) assure the availability and effectiveness of organizations for utilizing the assistance of the private sector, including the energy emergency executive reserves, and voluntary agreements and plans of action, in domestic and international energy emergencies in order to meet both defense-related and non-defense-related needs;

"(3) preserve the ability of the domestic marketplace to work effectively, in the event of a severe petroleum supply disruption, by protecting against the possibility that States or local governments may, by the adoption of price and allocation laws, interfere in the domestic marketplace and thereby worsen energy emergencies;

"(4) assure, commensurate with the Strategic Petroleum Reserve Distribution Plan and with existing legal authorities, that—

"(A) the Strategic Petroleum Reserve will be applied to meet domestic needs (including regional hardships) and can be applied to meet international obligations of the United States (including those under the International Energy Agency and

North Atlantic Treaty Organization agreements); and

"(B) petroleum products from the Strategic Petroleum Reserve, including any such petroleum products distributed by directed sales, enter the market during the energy emergency and are protected from speculation and hoarding; and

"(5) complete the Strategic Petroleum Reserve by—

"(A) developing a 750 million barrel Reserve by the end of fiscal year 1991;

"(B) maintaining an average annual fill rate over the fiscal years 1984 through 1988 of at least 145,000 barrels per day, with some necessary year-to-year flexibility to accommodate especially favorable purchases that may arise in the future; and

"(C) completing the Big Hill facility on a schedule that will allow fill of the facility to begin no later than the third quarter of fiscal year 1987.

"(b) Within 3 months after the date of enactment of this section, and annually thereafter, the Secretary of Energy shall submit a report to the Congress containing a description of the actions taken pursuant to subsection (a) and any other actions taken to strengthen and improve our Nation's energy emergency preparedness in order to further carry out the policy set forth in section 271(b) of the Energy Policy and Conservation Act (42 U.S.C. 6281(b)).".

ATTACHMENT 2

Public Law 97-229
97th Congress

An Act

Aug. 3, 1982
[S. 2332]

To amend the Energy Policy and Conservation Act to extend certain authorities relating to the International Energy Program, to provide for the Nation's energy emergency preparedness, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Energy Emergency Preparedness Act of 1982.
42 USC 6202 note.

SECTION 1. SHORT TITLE.

This Act may be cited as the "Energy Emergency Preparedness Act of 1982".

SEC. 2. INTERNATIONAL ENERGY PROGRAM AMENDMENTS.

Ante, p. 196.

(a) EXTENSION.—Subsection (j) of section 252 of the Energy Policy and Conservation Act (42 U.S.C. 6272(j)) is amended by striking out "August 1, 1982" and inserting in lieu thereof "at midnight December 31, 1983".

(b) LIMITATIONS.—(1) Section 251 of the Energy Policy and Conservation Act (42 U.S.C. 6271) is amended by adding at the end thereof the following new subsection:

"(e) No rule under this section may be put into effect unless—

"(1) an international energy supply emergency, as defined in the first sentence of section 252(l)(1), is in effect; and

"(2) the allocation of available oil referred to in chapter III of the international energy program has been activated pursuant to chapter IV of such program.".

(2) Section 252 of such Act (42 U.S.C. 6272) is amended by adding at the end thereof the following new subsection:

"(m) The authority granted by this section shall apply only to the development or carrying out of voluntary agreements and plans of action to implement chapters III, IV, and V of the international energy program.".

SEC. 3. ENERGY EMERGENCY PREPAREDNESS.

(a) IN GENERAL.—Title II of the Energy Policy and Conservation Act, relating to standby energy authorities, is amended by adding at the end thereof the following new part:

"PART C—ENERGY EMERGENCY PREPAREDNESS

"CONGRESSIONAL FINDINGS, POLICY, AND PURPOSE

42 USC 6281.

"SEC. 271. (a) FINDINGS.—The Congress finds that—

"(1) a shortage of petroleum products caused by reductions in imports of petroleum products may occur at any time;

"(2) such a shortage may be sufficiently large to cause severe economic dislocations and hardships, or constitute a serious threat to public health, safety, and welfare; and

"(3) prior to the occurrence of such a shortage, the Federal Government has a responsibility to be prepared to mitigate the adverse impacts of such a shortage as a supplement to reliance on free market pricing and allocation of available petroleum product supplies.

"(b) POLICY.—The Congress declares that it shall be the policy of the United States that the Federal Government shall be prepared prior to any shortage of petroleum products to respond to energy emergencies, pursuant to authorities under provisions of law other than this part, as a supplement to reliance on the free market to mitigate the adverse impacts of a shortage of petroleum products on public health, safety, and welfare.

"(c) PURPOSE.—The purpose of this part is to carry out the policy in subsection (b) by providing for the preparation of comprehensive energy emergency response procedures to be available for use by the President under authorities contained in any provision of law other than this part.

"PREPARATION FOR PETROLEUM SUPPLY INTERRUPTIONS

Memorandum of law, submittal to Congress.
42 USC 6282.

"SEC. 272. (a) DESCRIPTION OF AVAILABLE LEGAL AUTHORITIES.—(1) The President shall submit to the Congress no later than November 15, 1982, a memorandum of law which describes the nature and extent of the authorities available to the President under existing law to respond to a severe energy supply interruption or other substantial reduction in the amount of petroleum products available to the United States.

"(2) The memorandum of law required by paragraph (1) shall be prepared by the Attorney General, in consultation with the Secretary of Energy.

"(3) The memorandum of law submitted to the Congress pursuant to this subsection shall—

"(A) include the following subjects—

"(i) activities of the United States in support of the international energy program and the December 10, 1981, International Energy Agency agreement entitled 'Decision on Preparation for Future Supply Disruptions' including—

"(I) the National Emergency Sharing Organization;

"(II) emergency sharing systems; and

"(III) the supply right project;

"(ii) activities of the United States pursuant to its energy emergency preparedness obligations to the North Atlantic Treaty Organization;

"(iii) development and use of the Strategic Petroleum Reserve;

"(iv) Government incentives to encourage private petroleum product stocks;

"(v) reactivation of the following Executive Manpower Reserves:

"(I) the Emergency Electric Power Reserve;

"(II) the Emergency Petroleum and Gas Reserve; and

"(III) the Emergency Solid Fuels Reserve;

"(vi) energy emergency response management in coordination with State and local governments; and

"(vii) emergency public information activities; and

"(B) distinguish among—

"(i) situations involving limited or general war, international tensions that threaten national security, and other Presidentially declared emergencies;

"(ii) events resulting in activation of the international energy program; and

"(iii) events or situations less severe than those described in clauses (i) and (ii).

"(b) COMPREHENSIVE ENERGY EMERGENCY RESPONSE PROCEDURES.—(1) Not later than December 31, 1982, the President shall submit to the Congress comprehensive energy emergency response procedures for implementation, in whole or in part, of the authorities described under subsection (a).

"(2) The comprehensive energy emergency response procedures shall—

"(A) describe the various options the President would consider using to implement the authorities described in the memorandum of law submitted under subsection (a) to respond to a severe energy supply interruption or other substantial reduction in the amount of petroleum products available to the United States, including a description of the likely sequence in which such options would be taken;

"(B) specify how appropriate governmental actions in response to international and domestic energy shortages would be selected and implemented under such options, particularly which official or governmental entity would select and implement such actions, and what procedures would be used in doing so; and

"(C) recommend any additional statutory authority the President considers necessary to respond to a severe energy supply interruption or other substantial reduction in the amount of petroleum products available to the United States.

"(c) DISCLAIMERS.—(1) Nothing in this part, or in the comprehensive energy emergency response procedures submitted pursuant to subsection (b), shall—

"(A) limit the authority of the President under any provision of law to respond to a reduction in the amount of petroleum products available to the United States; or

"(B) grant any authority to the President to respond to a reduction in the amount of petroleum products available to the United States.

"(2) No State law or State program in effect on the date of the enactment of this part, or which may become effective thereafter, shall be construed to be superseded by any provision of this part.".

(b) CONFORMING AMENDMENT.—The table of contents for the Energy Policy and Conservation Act is amended by adding after the item relating to section 255 the following new items:

"PART C—ENERGY EMERGENCY PREPAREDNESS

"Sec. 271. Congressional findings, policy, and purpose.
"Sec. 272. Preparation for petroleum supply interruptions.".

SEC. 4. STRATEGIC PETROLEUM RESERVE AMENDMENTS.

(a) REQUIRED RATE FOR FILLING RESERVE.—

(1) IN GENERAL.—Subsection (c) of section 160 of the Energy Policy and Conservation Act (42 U.S.C. 6240(c)) is amended to read as follows:

"(c)(1)(A) The President shall immediately undertake, and thereafter continue, petroleum products acquisition, transportation, and injection activities, to the extent funds are available pursuant to section 167 (b)(2) and (b)(3), at a level sufficient to assure that the

42 USC 6247.

petroleum products in the Strategic Petroleum Reserve will be increased at an average annual rate of at least the minimum required fill rate until the quantity of petroleum products stored within the Strategic Petroleum Reserve is at least 500,000,000 barrels.

"(B) Subject to subparagraph (C), the minimum required fill rate shall be 300,000 barrels per day for purposes of subparagraph (A), unless there is in effect a finding by the President in his discretion for good cause that compliance with such rate would not be in the national interest. Any finding by the President under this subparagraph takes effect on the date such finding is transmitted to the Congress and ceases to have effect at the end of the fiscal year in which such finding was made. Any such finding transmitted to the Congress shall include a statement of the facts upon which the finding is based. Any such finding shall not be subject to judicial review.

"(C) The minimum required fill rate shall be 220,000 barrels per day for purposes of subparagraph (A) during the period in which any finding by the President under subparagraph (B) is in effect.

"(D)(i) If funds are available in any given fiscal year after fiscal year 1982 to achieve an average annual fill rate higher than the minimum required fill rate in effect under subparagraph (C), the minimum required fill rate shall be the highest practicable fill rate achievable, subject to the availability of appropriated funds.

"(ii) The Impoundment Control Act of 1974 (31 U.S.C. 1400 and following) shall apply to funds made available under section 167 (b) and (e).

42 USC 6247; *Infra.*

"(2) After the Strategic Petroleum Reserve reaches a level of 500,000,000 barrels, the President shall immediately seek to undertake, and thereafter continue, petroleum products acquisition, transportation, and injection activities at a level sufficient to assure that the petroleum products in the Strategic Petroleum Reserve will be increased at an average annual rate of at least 300,000 barrels per day until the quantity of petroleum products stored within the Strategic Petroleum Reserve is at least 750,000,000 barrels.".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect July 1, 1982.

42 USC 6240 note.

(b) INTERIM STORAGE.—

(1) AUTHORITY FOR IMPLEMENTATION.—Section 159(f) of the Energy Policy and Conservation Act (42 U.S.C. 6239(f)) is amended by striking out "and" at the end of paragraph (3), by striking out the comma at the end of paragraph (4) and inserting "; and" in lieu thereof, and by inserting after paragraph (4) the following new paragraph:

"(5) the storage of petroleum products in interim storage facilities,".

(2) USE OF SPR PETROLEUM ACCOUNT; CONFORMING AMENDMENTS.—(A) Section 167 of such Act (95 Stat. 619; to be codified at 42 U.S.C. 6247) is amended by adding at the end thereof the following:

"(e)(1) Except as provided in paragraph (2), nothing in this part shall be construed to limit the Account from being used to meet expenses relating to interim storage facilities for the storage of petroleum products for the Strategic Petroleum Reserve.

"(2) In any fiscal year, amounts in the Account may not be obligated for expenses relating to interim storage facilities in excess of 10 percent of the total amounts in the Account obligated in such fiscal year. If the amount obligated in any fiscal year for interim storage expenses is less than the amount of the 10-percent limit under the preceding sentence for that fiscal year, then the amount of the 10-percent limit applicable in the following fiscal year shall be increased by the amount by which the limit exceeded the amount obligated for such expenses.".

(B) Section 159 of such Act (42 U.S.C. 6239) is amended by adding at the end thereof the following new subsection:

"(h)(1) No amendment to the Strategic Petroleum Reserve Plan relating to interim storage facilities shall be required prior to the storage of petroleum products in such facilities.

"(2) Petroleum products stored in interim storage facilities pursuant to this part shall be considered to be in storage in the Reserve.

"(3)(A) No action relating to the storage of petroleum products in existing interim storage facilities in the Reserve shall be deemed to be 'a major Federal action significantly affecting the quality of the human environment' within the meaning of that term as it is used in section 102(2)(C) of the National Environmental Policy Act of 1969. 42 USC 4332.

"(B) For purposes of this paragraph, an interim storage facility shall be considered to be an existing interim storage facility if it—

"(i) is in existence on July 1, 1982;

"(ii) was constructed in a manner appropriate for storing petroleum products; and

"(iii) is not modified after July 1, 1982, in any manner which substantially increases the storage capacity of the facility. Any modification of such facility may not include replacement or reconstruction.

"Interim storage facilities." "(4) The term 'interim storage facilities', when used in this part, may include any vessel which meets the applicable requirements under this part.".

(C) Section 160(e)([illegible] Act (42 U.S.C. 6240(e)(4)) is amended by striki[illegible] oil" and inserting in lieu thereof "petroleum [illegible]

42 USC 6234 note. (c) Strategic Petrol[illegible]wdown Plan.—On or before December 1, 1982, [illegible] transmit to the Congress a drawdown plan for [illegible]leum Reserve consistent with the requirements [illegible] he Energy Policy and Conservation Act. Such plan shal[illegible]tted to the Congress as an amendment to the Strategic [illegible]um Reserve Plan. Such amendment shall take effect on the [illegible]te it is transmitted to the Congress and shall not be subject to section 159(e) of such Act relating to Congressional review. Subsequent amendments to such plan shall be in accordance with subsections (d) and (e) of such section 159.

42 USC 6234. Effective date.

42 USC 6239.

SEC. 5. CONTINUATION OF PETROLEUM PRODUCT INFORMATION COLLECTION.

(a) In General.—Part A of title V of the Energy Policy and Conservation Act (42 U.S.C. 6381 and following) is amended by adding at the end thereof the following new section:

"PETROLEUM PRODUCT INFORMATION

42 USC 6385. "Sec. 507. The President or his delegate shall, pursuant to authority otherwise available to the President or his delegate under any other provision of law, collect information on the pricing, supply,

and distribution of petroleum products by product category at the wholesale and retail levels, on a State-by-State basis, which was collected as of September 1, 1981, by the Energy Information Administration.".

(b) CLERICAL AMENDMENT.—The table of contents for such Act is amended by inserting the following new item after the item relating to section 506:

"Sec. 507. Petroleum product information.".

42 USC 6245 note.

SEC. 6. REPORTS TO CONGRESS ON PETROLEUM SUPPLY INTERRUPTIONS.

(a) IMPACT ANALYSIS.—(1) The Secretary of Energy shall analyze the impact on the domestic economy and on consumers in the United States of reliance on market allocation and pricing during any substantial reduction in the amount of petroleum products available to the United States. In making such analysis, the Secretary of Energy may consult with the Secretary of the Treasury, the Secretary of Agriculture, the Director of the Office of Management and Budget, and the heads of other appropriate Federal agencies. Such analysis shall—

Consultation with other Federal agencies.

(A) examine the equity and efficiency of such reliance,

(B) distinguish between the impacts of such reliance on various categories of business (including small business and agriculture) and on households of different income levels,

(C) specify the nature and administration of monetary and fiscal policies that would be followed including emergency tax cuts, emergency block grants, and emergency supplements to income maintenance programs, and

(D) describe the likely impact on the distribution of petroleum products of State and local laws and regulations (including emergency authorities) affecting the distribution of petroleum products.

Such analysis shall include projections of the effect of the petroleum supply reduction on the price of motor gasoline, home heating oil, and diesel fuel, and on Federal tax revenues, Federal royalty receipts, and State and local tax revenues.

(2) Within one year after the date of the enactment of this Act, the Secretary of Energy shall submit a report to the Congress and the President containing the analysis required by this subsection, including a detailed step-by-step description of the procedures by which the policies specified in paragraph (1)(C) would be accomplished in an emergency, along with such recommendations as the Secretary of Energy deems appropriate.

(b) STRATEGIC PETROLEUM RESERVE DRAWDOWN AND DISTRIBUTION REPORT.—The President shall prepare and transmit to the Congress, at the time he transmits the drawdown plan pursuant to section 4(c), a report containing—

(1) a description of the foreseeable situations (including selective and general embargoes, sabotage, war, act of God, or accident) which could result in a severe energy supply interruption or obligations of the United States arising under the international energy program necessitating distributions from the Strategic Petroleum Reserve, and

(2) a description of the strategy or alternative strategies of distribution which could reasonably be used to respond to each situation described under paragraph (1), together with the theory and justification underlying each such strategy.

The description of each strategy under paragraph (2) shall include an explanation of the methods which would likely be used to determine the price and distribution of petroleum products from the Reserve in any such distribution, and an explanation of the disposition of revenues arising from sales of any such petroleum products under the strategy.

Submittal to Congress.

(c) REGIONAL RESERVE REPORT.—The President or his delegate shall submit to the Congress no later than December 31, 1982, a report regarding the actions taken to comply with the provisions of section 157 of the Energy Policy and Conservation Act (42 U.S.C. 6237). Such report shall include an analysis of the economic benefits and costs of establishing Regional Petroleum Reserves, including—

(1) an assessment of the ability to transport petroleum products to refiners, distributors, and end users within the regions specified in section 157(a) of such Act;

(2) the comparative costs of creating and operating Regional Petroleum Reserves for such regions as compared to the costs of continuing current plans for the Strategic Petroleum Reserve; and

(3) a list of potential sites for Regional Petroleum Reserves.

(d) STRATEGIC ALCOHOL FUEL RESERVE REPORT.—The Secretary of Energy shall, in consultation with the Secretary of Agriculture, prepare and transmit to the Congress no later than December 31, 1982, a study of the potential for establishing a Strategic Alcohol Fuel Reserve.

(e) MEANING OF TERMS.—As used in this section, the terms "international energy program", "petroleum product", "Reserve", "severe energy supply interruption", and "Strategic Petroleum Reserve" have the meanings given such terms in sections 3 and 152 of the Energy Policy and Conservation Act (42 U.S.C. 6202 and 6232).

Approved August 3, 1982.

LEGISLATIVE HISTORY—S. 2332 (H.R. 6337):

HOUSE REPORTS: No. 97-585, pt. 1 (Comm. on Energy and Commerce), 97-585, pt. 2 (Comm. on Merchant Marine and Fisheries) both accompanying H.R. 6337; and 97-663 (Comm. of Conference).
SENATE REPORT No. 97-393 (Comm. on Energy and Natural Resources).
CONGRESSIONAL RECORD, Vol. 128 (1982):
  May 26, considered and passed Senate.
  June 23, H.R. 6337 considered and passed House; passage vacated and S. 2332, amended, passed in lieu.
  July 29, House agreed to conference report.
  July 30, Senate agreed to conference report.
WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS, Vol. 18, No. 31 (1982):
  Aug. 3, Presidential statement.

ELEMENTS OF AGREEMENT ON STRATEGIC PETROLEUM RESERVE AND ENERGY EMERGENCY PREPAREDNESS

July 19, 1983

The agreement includes the following elements to strengthen our Nation's energy emergency preparedness which are outlined in Secretary Hodel's letter of July 19, 1983 to Chairman McClure:

(1) legislation to assure legally the availability and effectiveness of the Executive Manpower Reserves in domestic and international energy emergencies in order to meet both defense-related and non-defense-related needs;

(2) extension of Section 252 of the Energy Policy and Conservation Act (EPCA), pertaining to the International Energy Agency antitrust defense, to coincide with the EPCA expiration date of June 30, 1985;

(3) identification and Administration support for legislation to correct shortfalls in existing emergency preparedness legislation, such as current provisions which require clarification or which contain inconsistencies which may impede proper implementation of the current energy emergency preparedness policies established in Section 271 of the EPCA;

(4) appropriate legal resolution to protect against the possibility that States or local governments may, by the adoption of price and allocation laws, interfere in the domestic marketplace and thereby worsen energy emergencies, so as to preserve the ability of the domestic marketplace to work effectively in the event of a severe petroleum supply disruption;

(5) appropriate administrative action on a timely basis to continue an effort to improve and to upgrade the Comprehensive Energy Emergency Response Procedures contemplated by the Energy Emergency Preparedness Act of 1982 so as to assure achievement of the preparedness policies and purposes of Section 271 of EPCA, including a continuing effort to determine, in light of results of ongoing tests and exercises, the improvements which may be needed in the areas of internal Department of Energy organization, inter-agency coordination, decision-making procedures and emergency alert systems and logistics support; and

(6) administrative actions, commensurate with the existing SPR drawdown plan and other presently effective, associated legal authorities with a view to development of measures necessary (a) to assure that the SPR will be applied to meet domestic needs, including regional hardships, and foreign obligations, including those under the International Energy Agency and NATO agreements, and (b) to assure that SPR oil, including any SPR oil distributed by directed sales, enters the market during the emergency and will be protected against speculation and hoarding.

The agreement includes the following elements which form a commitment to completion of the Strategic Petroleum Reserve which are set forth in OMB Director Stockman's letter of July 19, 1983:

(1) development of the full 750 million barrel reserve by the end of FY 1991;

(2) requesting funds for major construction at Big Hill in the budget for FY 1985 that will be submitted to Congress next January;

(3) requesting funds for oil acquisition sufficient to maintain a fill rate over the 1984-88 period of at least 145,000 barrels per day, with some necessary year-to-year flexibility to accommodate especially favorable purchases that may arise in the future; and,

(4) completion of Big Hill on a schedule that will allow fill of the facility to begin no later than the third quarter of FY 1987.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

JUL 1 9 1983

Honorable James A. McClure, Chairman
Subcommittee on Interior and Related Agencies
Committee on Appropriations
United States Senate
Washington, D.C. 20510

Dear Jim:

I appreciate the opportunity to clarify for you the Administration's plans for funding completion of the Strategic Petroleum Reserve.

As is evident from the rapid acceleration of oil purchases undertaken by this Administration soon after the President's inauguration, we share the strong commitment to the Strategic Petroleum Reserve expressed by the Congress through the actions of both the appropriations and authorizing committees.

The plan to which we are committed, developed after consultation with the Congress, calls for the following:

-- Development of the full 750 million barrel reserve by the end of FY 1991.

-- Requesting funds for major construction at Big Hill in the budget for FY 1985 that will be submitted to Congress next January.

-- Requesting funds for oil acquisition sufficient to maintain a fill rate over the 1984-88 period of at least 145,000 barrels per day, with some necessary year-to-year flexibility to accommodate especially favorable purchases that may arise in the future.

-- Completion of Big Hill on a schedule that will allow fill of the facility to begin no later than the third quarter of FY 1987.

We believe that this plan balances fiscal policy objectives and the need to complete our energy security preparations in timely fashion. In this regard, it is very important to note that other actions of this Administration, such as immediate decontrol of oil, have greatly enhanced the level of protection provided by the more than 400 million barrels we will have in storage by next year.

The Strategic Petroleum Reserve is just one facet of our energy emergency preparedness effort. As part of our continued effort to work with Congress to take the necessary steps to ensure such preparedness, we plan to implement certain additional actions, which are outlined in a letter to you from Secretary Hodel sent under separate cover.

I am certain that Secretary Hodel and I would be pleased to provide any further clarification you might require on these important issues.

Sincerely,

David A. Stockman

David A. Stockman
Director

IDENTICAL LETTERS SENT TO:

Honorable J. Bennett Johnston, U.S.S.
Honorable Sidney R. Yates, M.C.
Honorable Joseph McDade, M.C.

THE SECRETARY OF ENERGY
WASHINGTON, D.C. 20585

July 19, 1983

Honorable James A. McClure
Chairman
Committee on Energy and Natural Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

As recent correspondence to you from the Director of the Office of Management and Budget makes clear, this Administration shares with the Congress a strong commitment to the Strategic Petroleum Reserve (SPR). However, as Mr. Stockman has stated, the SPR is just one part of our Nation's energy emergency preparedness efforts. Such efforts, in turn, constitute but a facet of the President's determination that the United States maintain and improve its defense and national security positions.

I publicly have recognized that adequate energy emergency preparedness may require certain, carefully defined legislative action. Specifically, I have testified to my willingness to seek legislation to assure legally the availability and effectiveness of the Executive Manpower Reserves in domestic and international energy emergencies in order to meet both defense-related and non-defense-related needs. I have supported extension of Section 252 of the Energy Policy and Conservation Act (EPCA), pertaining to the International Energy Agency antitrust defense, to coincide with the EPCA expiration date of June 30, 1985. In addition, I have promised to identify, and to support corrective legislation in regard to, shortfalls in existing emergency preparedness legislation, such as current provisions which require clarification or which contain inconsistencies, which I believe may impede proper implementation of the current energy emergency preparedness policies established in Section 271 of the EPCA.

You and others have called to my attention the possible need for legislation to preserve the ability of the domestic marketplace to work effectively in the event of a severe petroleum supply disruption. The concern has been expressed that states or local governments may interfere, and thereby worsen the situation, by adoption of petroleum price and allocation laws. My understanding is that members of your Committee may be considering legislation designed to protect against such interference, and we agree to work with you to achieve an appropriate legal resolution to this problem.

A principal purpose of this letter is to express the commitment of this Administration to enter into a prompt and meaningful dialogue with you and other members of the Congress who have expressed interest or concern about these matters, with a view to developing acceptable legislation which appropriately deals with these issues. Such acceptable legislation having been developed, the Administration will lend its full support to the required legislative program. On the other hand, I must inform you I will not hesitate to recommend to the President that he veto any energy emergency preparedness legislation, including but not limited to petroleum price or allocation controls, which exceed the scope of the legislative possibilities described above.

Comprehensive energy emergency preparedness may be furthered also by appropriate administrative action on a timely basis. The Department of Energy already has embarked upon, and I am determined to continue, an effort to improve and to upgrade the comprehensive energy emergency response procedures contemplated by the Energy Emergency Preparedness Act of 1982 so as to assure achievement of the preparedness policies and purposes of Section 271 of EPCA. Among other things, we shall continue to determine, in light of results of ongoing tests and exercises, the improvements which may be needed in the areas of internal Department of Energy organization, inter-agency coordination, decision-making procedures and emergency alert systems and logistics support.

An analysis of prudent administrative actions, commensurate with the existing SPR drawdown plan and other presently effective, associated legal authorities, already is underway, and will continue, with a view to development of measures necessary to assure that the SPR will be applied to meet domestic needs, including regional hardships, and foreign obligations, including those under the International Energy Agency and NATO agreements, and also to assure that SPR oil, including any SPR oil distributed by directed sales, enters the market during the emergency and will be protected against speculation and hoarding.

As plans for the abovementioned administrative actions progress, I shall communicate appropriately with the Congress.

Incidentally, I am informed by Mr. Stockman's office that there was a typographical error in the sentence of his letter to you pertaining to completion of Big Hill. The sentence was intended to refer to "completion of Big Hill on a schedule that will allow fill of the facility to begin no later than the third quarter of fiscal year 1987."

The long-standing concerns you and other members of Congress repeatedly have expressed about the energy emergency preparedness of our Nation are taken most seriously by the Administration. We look forward to working with you and with them on this all-important subject.

Sincerely yours,

Donald Paul Hodel

DONALD PAUL HODEL

cc: Honorable J. Bennett Johnston
Honorable John D. Dingell
Honorable James T. Broyhill

Statement by Dr. Ulf Lantzke
Executive Director, International Energy Agency

Committee on Energy and Natural Resources
United States Senate
19 October 1983

Introduction

The International Energy Agency (IEA) was formed in 1974 and is composed of 21 major industrialized countries. The European Economic Commission also participates in IEA activities. My statement will cover the origins of the IEA and focus on the role of the IEA in coping with significant oil supply disruptions.

Major decisions of the IEA are made by the Governing Board, composed of Ministers, or their high-ranking representatives, from each of the participating countries. Four Standing Groups and a Committee on Research and Development report to the Governing Board. The Standing Groups each deal with a principal area of concern to IEA governments namely, long-term energy cooperation, the oil market, emergency questions, and relations with producer and other consumer countries. The IEA Secretariat, which is headed by the Executive Director, is composed of 60 professionals, including 14 Americans.

Industrialized countries had one overriding objective in setting up the IEA. This was to protect the economies of oil consuming countries from serious adverse economic impact resulting from highly unusual developments in energy markets, but principally the oil market.

There was also a basic, underlying political objective in setting up the IEA, one which went beyond the need for pragmatic measures to deal with major oil disruptions. This was to reduce the possibility that energy could become a source of friction among Western industrialized countries. It is natural that industrialized democracies will have differences of opinion on the fundamental issues confronting them. There are areas of potential strain - in the economic, financial and social spheres - where disagreement can disrupt efforts to reach consensus on the basic issues facing industrialized democracies. Energy should not, and need not, be among them. The technical, financial and natural resources needed to cope with the energy problems of the foreseeable future exist within IEA countries as a group.

Having said this, I recognize that the means by which individual countries achieve agreement upon energy objectives may differ. But it is important that in seeking national solutions, we do not disregard the problems and potentials of other nations. It is essential to have a forum where countries can present national objectives and strategies and discuss the implications of these for the international community as a whole as well as individual countries.

The Need for Emergency Preparedness

With this background, I wish to turn to the role of the IEA in handling significant disruptions in oil supplies. Under the International Energy Program signed in Novemebr 1974, member countries of the IEA have committed themselves to cooperate closely should external events disrupt 7% or more of IEA oil supplies. The formal emergency sharing system ensures that the remaining available oil is shared in a fair and equitable manner among IEA members in times of major disruptions. To achieve this goal, the system is composed of four major components:

1) a commitment to hold oil stocks of not less than 90 days' net imports which practically speaking all member countries have met;

2) a commitment to reduce demand -- the amount depending on severity of a given situation;

3) equitable allocation of remaining oil supplies; and

4) an international data reporting system based upon submissions from 47 oil companies covering 80 percent of international oil supply.

It is important to note that the responsibility of the IEA sharing system ends when each country has received its fair share of available oil. Thus distribution of oil within a national economy in an emergency is the sole responsibility of national authorities. The International Energy Program (IEP), recognizing that economic systems vary among industrialized countries, quite deliberately does not suggest how individual countries should satisfy the oil requirements of their citizens. There are, however, two exceptions where the IEA does have a direct interest in the domestic policies of national authorities:

> first, Article 5 of the IEP requires each member country to have ready at all times a program of contingent oil demand restraint measures enabling it to reduce its rate of consumption in accordance with the severity of the disruption;
>
> second, should national means of dealing with a disruption have a negative impact on the international allocation of oil, the IEA could not ignore the situation. Article 9.4 of the IEP, for instance, contains an implicit recognition that should there not be an equitable domestic allocation of oil, this could hinder the overall functioning of the voluntary offer system.

I will return to these points in discussing the results of the most recent test of the IEA's oil allocation system.

To complement the international emergency sharing system, most Member countries have developed a compatible national system for coping with an oil shortage. These national emergency sharing organisations (NESO), established on a stand-by basis, would be responsible for national oil emergency measures and consult with the IEA on matters of international allocation in an emergency. Subject to observing IEA demand restraint commitments, each NESO has complete discretion over the national emergency oil allocation measures it implements. It is presumed that government authority for national oil emergency management would involve cooperation with oil companies operating nationally. For the effective working of the IEA's international oil allocation system, it is necessary that NESOs ensure, as far as possible, that companies which give up oil for international allocation are not disadvantaged nationally.

Specific NESO responsibilities under the IEA emergency sharing system include:

- to collect and submit data to the IEA Secretariat including the data for companies which do not report directly to the IEA;
- to maintain an accurate national data base and monitoring system to facilitate fair sharing provisions;
- to coordinate in cooperation with industry the implementation of national demand restraint measures, stock policy and refinery yield policies;
- to assess the national product supply and demand situation to ensure that all efforts are made to solve national product imbalances locally.

The Non-Emergency Situation

The IEP does not specifically deal with supply disruptions of less than 7%. When the IEP was negotiated, it was the common view that this type of situation could be taken care of by the flexibility of the market. However, we have seen this flexibility diminish in recent years. The rapid and massive oil price increases in 1979 imposed high economic costs on societies, costs which might have been moderated by supplementary government action.

In any case, the situation in 1979-80 developed into one harmful to the collective interests of industrialized nations, and, indeed, to the world economy. It needs to be borne in mind that the world oil market is characterised by a high degree of political control over supply. In such circumstances, at least in the short-term, and at times when supply and demand are closely balanced and little spare capacity exists, market forces can really act only on the demand side, and even there only with some delay. The result can be -- as we have seen -- extraordinarily large increases in oil prices, with depressing effects on economic growth as wealth is rapidly transferred to oil producers. It is therefore only prudent for Western industrialized countries in the IEA to prepare contingency plans, including the possibility of collective government action, which could be brought into effect to supplement market forces when necessary.

IEA Ministers have expressed the determination of their governments that the IEA and its member countries should be prepared to prevent a disruption in oil supply from again resulting in sharply higher prices and severe economic damage. They agreed that the full implementation and strengthening of market forces in consuming countries would contribute heavily to this objective. In addition, they felt that supplementary action by governments might be necessary in those areas where market forces do not sufficiently counteract the adverse impact of supply disruptions, particularly in international markets. IEA Ministers stated that, were such action to be necessary, it would have to be flexible in responding to the particular situation at hand and at the same time be taken promptly and effectively.

Responding to the request of Ministers, the IEA Governing Board in December 1981 agreed on measures which it could, inter alia, consider should a minor supply disruption occur. These measures would include those which had been used in the past, such as:

- discouragement of abnormal spot market purchases or other undesirable purchases
- lowered consumption
- short-term fuel switching
- high levels of indigenous production
- stocks and stock policies, through government consultation with oil companies

- informal efforts to minimize and contain the effects of supply imbalances

Any measures which are agreed upon by the Governing Board will be applied on an IEA-wide basis, although the detailed methods of implementation will be decided by governments in accordance with national law and the IEP, and could vary from country to country while aimed at achieving the overall result desired on an common basis.

I would conclude from this brief discussion that there are at least three essential components of a successful contingency plan. They are:

- a functioning and reliable data system;

- preparedness of governments to respond quickly when a supply disruption occurs and, if necessary, to take action; and

- an ability of oil companies to provide the underlying data to national governments and contribute to the overall results decided upon by governments.

System Readiness

I wish now to turn to the actual state of the emergency sharing system. The emergency sharing system has been tested under simulated crisis conditions four times over the past several years. As a result of the tests, the major components of the system are constantly being modified to keep them in line with changing oil market conditions.

The most recent allocation system test (known popularly as AST-4), was held at the IEA headquarters in Paris, and in member countries in May - June 1983. The objectives of the test were to:

(a) continue the program of periodic training of personnel in participating countries, oil companies and the

Secretariat in the data systems and emergency oil allocation procedures;

(b) place special emphasis on and involve to the fullest extent all elements of the NESO in each participating country that are essential to the efficient and successful operation of the IEA emergency oil sharing system, including national emergency procedures;

(c) test modifications and improvements made to the systems and procedures since the last test (AST-3) held in October-November 1980; and

(c) identify ways in which the actual functionning of the Voluntary Offer System could be improved.

AST-4 was a volumetric and logistical exercise which did not involve the physical movement of any oil. The test did not address the commercial aspects of oil reallocation, in particular pricing, and thus gave no answers to the admittedly very difficult issue of the commercial aspects of oil transfers in an emergency. The participants in the test - governments, oil companies and the IEA Secretariat - are still discussing the results of the exercise. But I can assure you that AST-4 proved conclusively that, mechanically and operationally, the Emergency Sharing System will perform as envisioned.

AST-4 demonstrated the ability of the IEA, through the emergency oil sharing system of the IEP, to respond in a timely and effective fashion to a serious disruption of oil supplies and to supply each member country with a fair share of total available oil supply in accordance with the IEP. The test provided valuable training to all participants in the emergency sharing system. This was particularly important given the normal turnover between tests of the government, industry and Secretariat personnel involved. Of the 72 people involved in the test at the IEA headquarters in Paris, 40 were participating for the first time. I do not have similar figures for NESOs but it is reasonable to assume there was also a significant turnover in personnel since AST-3. The smooth functioning of the system in an emergency will depend critically on the informed judgement of knowledgeable individuals. This is why I place such high importance on the training of personnel on a regular basis.

The modifications and improvements made to the systems and procedures since AST-3 were tested and proved appropriate and effective. The newly developed computer system and associated programs for handling of Voluntary Offers worked especially well and were found to contribute significantly to the smooth functioning of the emergency mechanism.

Although no serious deficiency of the IEA emergency system was identified, AST-4 confirmed that, given the ever changing market situation, the turnover of personnel involved in the allocation system, and the rather elaborate system of data submission and handling on which the whole mechanism of oil-sharing is based, similar tests need to be regularly, preferably once every two years.

Issues for Further Consideration

I do not want to give the impression that everything went perfectly in AST-4. It was a test and thus designed to point out potential weaknesses in the ability of member countries to respond effectively to a major oil supply disruption. The test did reveal some problem areas. I will briefly outline the major issues which will require serious review by governments, oil companies and the Secretariat, recognizing that numerous issues of a more technical nature need also to be addressed:

1. Problems arose from the fact that Member countries chose different systems to bring about demand restraint. One country chose to rely exclusively on market forces (calculating that the world market price for crude oil would rise from $ 37 to $ 98 per barrel); whereas all other countries used, to varying

degrees, government-directed demand restraint programs. The divergence between these approaches to demand restraint would obviously influence the overall operation of the emergency sharing system, and in particular the commercial conditions of individual transactions.

2. The impact of the availability of National Fair Sharing arrangements on the willingness of individual oil companies to submit Voluntary Offers needs further study. In particular, individual companies will need a minimum degree of assurance that their participation in alleviating a severe emergency will not result in totally abnormal changes in their market shares.

3. One new element in AST-4 was that Voluntary Offers from NESOs (on behalf of Non-Reporting-Companies), and particularly from the U.S. NESO, played a very important role in the fulfillment of countries' Allocation Rights and Obligations. There were, however, some problems with the specification of the oil quantity and quality and of the logistical arrangements in these offers, so that many offers could not be used.

4. In order to have more complete knowledge about the three items above, the Secretariat has been requested, in line with the provisions of Articles 5 and 6 of the IEP, to look into the emergency response programs of several countries, including the United States, with a view to examine potential effects on the functioning of the international system, in particular the voluntary offer part.

5. The advisability and feasibility of introducing company to company commercial elements into future tests remains an issue for consideration before future tests.

6. Similarly, the advisability and feasibility of assuming an agreed world price level (whether arbitrary or in simulation of the market response to

the hypothesized disruption) should be considered as a means for reducing conflicting assumptions by different countries in future tests.

7. Import/Export discrepancies were a particularly important problem in AST-4. It was suggested that a means for discussing these problems, perhaps first among concerned and interested countries with the support of the Secretariat, be found.

8. The level of demand restraint to be applied to international aviation fuel may also require discussion.

9. The desirability of practice submissions of emergency data questionnaires in those years when there is no Allocation Systems Test should be considered not only for training purposes but also to provide a data base for the next test. In this connection, it was felt that the next Test should be held in approximately 2 1/2 years, and for planning purposes the autumn of 1985 has been suggested.

There are no easy answers to these issues and there are legitimate differences of opinion on the correct approach to take. At the latest meeting of the IEA Governing Board on October 5, it was agreed that these issues require serious attention at high level in member governments. I am confident that in the coming months we will reach consensus on these points.

Conclusions

I would like to conclude my statement with some comments on the U.S. participation in the IEA. The U.S. is the largest consumer and producer of energy within the IEA group of countries. Strong leadership by the U.S is essential to maintaining smooth economic and energy relations among industrialized countries. This was clearly recognized by the U.S. when it took the lead in 1974 in creating the IEA. Therefore, what the U.S. does, or does not do, in energy policy is of significance to all IEA countries. This is particularly true in connection with the emergency oil sharing system.

The U.S. has made substantial progress over the years to use energy more efficiently and to promote the development of alternative energy sources. The continuing build-up of the Strategic Petroleum Reserve will provide a significant asset in time of emergency. The availability of emergency preparedness measures to help the U.S. meet its commitments to the IEP would be very desirable, as would the extension of the anti-trust defense for U.S. companies, as provided for in the bill before the Energy Committee. The IEA Secretariat is prepared to provide whatever assistance would be helpful as the U.S. reviews its participation in AST-4.

I would like to emphasize in conclusion that energy cannot be considered an end in itself, but rather must be considered in the overall context of the economic, political and security interests of the Western world. That has been the framework within which IEA member countries have operated since 1974.

We must remain vigilant to potential disruptions to global oil supplies. We must resist the temptation, in a period of calm on the oil market, to dissipate the achievements of the past eight years. We need to re-examine what is meant by the stability of energy relations. This is true for all international energy arrangements, be it oil, coal, gas or nuclear. We face an intellectual and political challenge to fit the various aspects of international energy supply into a coherent framework. Clearly, the industrialized countries are just one part of the global energy picture. However, provided we also have the necessary political will, we do have the means to bring together energy policymakers in a common effort to secure a stable energy future.

W4170B

The **Chairman**. Senator Metzenbaum, among others, has asked that we take a look at IEA operations and we will do that. And the arrangements is that, we'll do that in conjunction with the hearing on this legislation. I'm pleased that Senator Metzenbaum is able to be in attendance this morning at this hour and I note his prompt arrival. I recognize him if he has any statement that he'd like to make at this time.

STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator **Metzenbaum**. Thank you very much, Mr. Chairman. I do, indeed. And I am concerned that in our giving attention to your bill that we will overlook the real issue of having to do with whether or not this Nation should or should not continue to be a member of the IEA. And I will address myself to that subject further on in my remarks this morning.

But I would say that I don't often take issue with some statement that you make, but in this instance I do, where you indicate that progress has been made with respect to energy emergency preparedness. I think just the opposite has occurred, Mr. Chairman. And I believe that we're living in a make believe world, a world where this administration has concluded that all the problems of allocation, all the problems of availability, or all the problems with respect to the energy needs of this country can be resolved by merely saying, well, if there isn't enough available, let the market conditions prevail, and people will just have to pay more for gasoline or oil, as the case may be.

Now, this administration will probably live for posterity, not for its activities with respect to the economy, and not with respect to its activities in foreign affairs, or not with respect to its farm program, but it is this Senator's opinion it will live for posterity in ignominy on the basis that it has no energy policy. It has no program with respect to allocation in the event of a shortage. As a matter of fact, the President vetoed the standby oil allocation bill. It has no program with respect to distribution of the oil that's in SPR. It's hard to believe that the man who is President of the United States is so callous and indifferent to the realities of the world in which we live that there is no program. The administration has turned its back and slammed the door on every program for conservation in this country. There is no program for conservation in this Nation, notwithstanding the fact that several years ago we all sat here and we were overwhelmed as Mr. Schlesinger and others came and told us about the shortages that were going to be coming down the road.

All of a sudden there's a little glut of oil because economic conditions in the world have changed. There isn't as much consumption, and apparently no programs for conservation are needed. We've practically slammed the door down on development of alternative energy resources.

I remember we used to come to this committee and all we'd hear about was solar energy, geothermal, shale oil, and a host of other areas in which we were going to develop alternative energy resources. We sat here and provided billions of dollars for the Synthetic Fuels Corporation and it's but a whisper on the whole panorama of discussion of energy in this country.

What will the Federal Government do to protect our citizens, our people; if imports are again disrupted? Is the United States ready this time? Hell, no. We don't have a program. This bill is no program. The administration doesn't have a program.

Unbelievably, we are totally unprepared. Today's hearing comes at a time when we're faced with a real possibility of another major oil disruption in the Mideast. Last week France announced plans to send five Super Entendard warplanes equipped with Exocet missiles to Iraq for possible use in its long war against Iran.

In response, Iran has warned that Western nations could face a very cold winter.

The Ayatollah Khomeini has threatened to close down the Strait of Hormuz. Fully one-fourth of all oil for the non-Communist world is shipped through that narrow body of water.

The United States has sent three amphibious assault ships and a frigate to the Arabian Sea. Pentagon officials said the ships, which carried more than 1,600 marines, were moved into the area as a precautionary measure.

Meanwhile, Saudi Arabia and five other nations of the United Arab Emirates are holding joint military exercises.

The threat of a new oil shortage is a real threat. This administration is indifferent. Even Mr. Shultz said the other day that they don't take the Iran threat as a real one, not very serious.

In 1973 the United States lost 1 million barrels of oil per day during the OPEC boycott. The result was panic at the gas lines, hoarding of private stocks, and escalating prices. We all remember those days. I remember I'd stand up on Wisconsin Avenue and wait maybe a half hour or 40 minutes to get in line to buy some gasoline. A million barrels of oil was cut during that period.

In 1979 Iranian oil was cut off to the United States. Although other producing nations stepped in to help us out, the effect was much the same—panic buying, hoarding, and almost a double of gasoline prices.

Today's potential energy shortage would dwarf the actual problems we experienced in 1973 and 1979.

If the Ayatollah Khomeini decides to block the Strait of Hormuz, the United States would automatically lose 1.3 million barrels per day of oil. The sad fact, Mr. Chairman, is that under our agreements with our Western countries we will lose 2.4 million barrels per day. In other words, we would lose 1.3 automatically, but under our agreements under which we give up oil to our allies, we would be losing 2.4 million barrels of oil a day.

What's the Federal Government's response? The Reagan administration's official position is to do nothing.

According to a recent mock drill conducted by the IEA that Mr. Chairman alluded to, using circumstances almost exactly parallel to today's real world situation, the Reagan administration has officially stated it will not intervene to protect the American consumer.

The Reagan administration absolutely refuses to require major industries to switch to coal.

All legislative hearings we held about the need to switch to coal have gone by the board. Nobody ever heard of those hearings. Nobody remembers those hearings. No mandatory conservation program would be put into effect.

Instead, the Reagan administration would let oil prices more than triple to $98 per barrel, from about $30 to $98 per barrel. Gasoline prices would shoot up to $2.98. These aren't my figures; these are the administration figures. Home heating oil would go from $1.16 per gallon to $1.94. No Federal efforts would be made to allocate gas and fuel to farmers to insure our food supply. Inflation would increase by almost 10 percent. Interest rates would climb by three percent. Almost 2 million people, more, would be put out of work. But the administration still says it would do nothing.

Mr. Chairman, I believe the administration is being politically naive. I believe it's being irresponsible. I do not believe the American people will stand by idly and let the oil prices triple to $98 a barrel in the middle of a world oil crisis. You would create chaos in this country if that were to occur. The American people will demand action. And I believe we have the responsibility to provide that action here today and to plan for future action as well.

I have many questions of our witnesses today, both with regard to the real world problems and with regard to the mock test that the United States participated in.

As you know, I am particularly concerned with the antitrust exemptions in current law. That exemption allows the world's major oil companies to sit down at a table in a time of major shortages and agree to allocate the world's oil supplies. To say the least, I don't trust that and I don't think it's good policy.

Now our distinguished chairman has introduced legislation that would go far further. It would allow private interests, including the major oil companies, to sit down and establish so-called voluntary agreements and plans of action. They would be allowed, with complete immunity from the antitrust laws, to enter into the voluntary agreements; complete immunity. And they would be exempted from all Federal conflict of interest laws.

How absurd can we possibly get? How can we sit here and advocate total absence of conflict of interest laws? How can we say that the antitrust laws should be totally negated?

This is nothing short of turning our country over to the major oil companies in the time of a major oil shortage. Major oil companies in this country, in my opinion, practically dominate the economic scene, anyhow. Now, by legislation, we want to make certain that they do. I'm talking now about the IEA itself and our participation.

Even under that legislation, the antitrust exemption that exists provides for a certain amount of monitoring of their activities, of the oil company activities. Not so in the McClure proposal. But even with it, our participation in the IEA doesn't make good sense for this country, in my opinion.

We've been in the IEA since 1974. I'm not sure of the exact time. And what will occur when there is a 7-percent oil shortfall, when the IEA can declare an emergency? Our Nation winds up giving the oil to the other nations of the world.

Now, at one point in my legislative career I saw fit to go over to an IEA meeting. And as I sat there I was embarrassed for my own country because I heard my own country absolutely lambasted by the other nations who were sitting around the table. These are the same countries to whom we were agreeing to give up oil to in the event of an emergency, in the event of a 7-percent shortfall. And then I heard an agreement come out of that meeting that each nation would cut back on its consumption 5 percent. The United States did what it was supposed to do. Many of the other nations did not and some of them actually increased their consumption.

I know of no good logical reason in this Nation's interest why our further participation in the IEA is justified. Now if you ask me should we under certain circumstances be willing to help England or Germany or France or Italy or Japan in the event of a shortage, I would say unequivocally yes. But there is no logical reason why we should be in this broad based plan agreed to give up our oil to other nations unless there is a real need shown.

And, unfortunately, in this instance our Nation has ceded to this international body the right to make a determination over which our Nation has no control. I believe it's illogical.

And I must say to you, Mr. Chairman, that I have some difficulty in understanding how some of the great conservatives of the U.S. Senate and the Congress who have so often talked about America's role in the world and America's international relationships, how you can agree and think that it's appropriate for our Nation to participate in an international body over which we have very little control and very little say, to permit that international body to require our Nation to give up substantial millions of barrels of oil a year to other nations without any justification being proven.

I repeat, if there's an emergency, I'm prepared to have our Nation help our allies. But if there is no emergency and if the emergency doesn't exist to all of the countries, then I don't think it makes good sense for our Nation, as a policy, to be a party to such an agreement and to be required, without the right to make the decision ourselves, to be required by an international body to give up that kind of oil.

Mr. Chairman, I have many questions and concerns about this bill. I have strong feelings about our further participation in the IEA. I don't believe that the hearing today will focus on the issue of whether we should or should not belong in the IEA. And pursuant to the understanding which you and I have reached, if they do not, and I don't believe that they do, I would hope that you would see fit to set up further hearings on that issue alone which is pursuant to our agreement.

[The prepared statement of Senator Metzenbaum follows:]

U. S. Senator Howard M.

METZENBAUM

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[illegible]
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FOR IMMEDIATE RELEASE

STATEMENT BY SENATOR HOWARD M. METZENBAUM

BEFORE THE SENATE ENERGY COMMITTEE ON THE INTERNATIONAL ENERGY ADMINISTRATION

MR. CHAIRMAN: Yesterday was the 10th anniversary of the 1973 Arab oil boycott. Today we are faced with the question: Are we better prepared?

What will the federal government do to protect our citizens if our imports are again disrupted? Is the United States ready this time?

Unbelievably, we are not.

Today's hearing comes at a time when we are faced with a real possibility of another major oil disruption in the Mideast.

Just last week France announced plans to send five super entendard warplanes equipped with exocet missiles to Iraq for possible use in its long war against Iran.

In response, Iran has warned that western nations could face "a very cold winter."

The Ayatollah Khomeini has threatened to close down the Strait of Hormuz. Fully one-fourth of all oil for the non-communist world is shipped through that narrow body of water.

The United States has sent three amphibious assault ships and a frigate to the Arabian Sea. Pentagon officials said the ships, which carried more than 1,600 marines, were moved into the area as "a precautionary measure."

Meanwhile, Saudi Arabia and five other nations of the United Arab Emirates are holding joint military exercises.

The threat of a new oil shortage is real.

In 1973, the U.S. lost one million barrels of oil per day during the OPEC boycott. The result was panic at the gas lines, hoarding of private stocks, and escalating prices. We can all remember those days.

In 1979, Iranian oil was cut off to the U.S. Although other producing nations stepped in to help us out, the effect was much the same -- panic buying, hoarding and almost a double of gasoline prices.

Today's potential energy shortage would dwarf the actual problems we experienced in 1973 and 1979.

If the Ayatollah Knomeini decides to block the Strait of Hormuz, the U.S. would automatically lose 1.3 million b/d of oil. And under our agreements with our western countries we would lose 2.4 million b/d.

What is the federal government response? The Reagan administration's official position is to do nothing.

According to a recent mock drill conducted by the International Energy Administration, using circumstances almost exactly parallel to today's real world situation, the Reagan administration has officially stated it will not intervene to protect the American consumer.

The Reagan administration absolutely refuses to require major industries to switch to coal.

No mandatory conservation program would be put into effect.

Instead, the Reagan administration would let oil prices more than triple to $98 per barrel.

-Gasoline prices would shoot up to $2.03.

- Home heating oil would go from $1.16 per gallon to $1.94.

- No federal efforts would be made to allocate gas and fuel to farmers to insure our food supply.

-Inflation would increase by almost 10 percent.

- Interest rates would climb 3 percent.

- Almost 2 million people would be put out of work.

But the administration says it would still do nothing.

Mr. Chairman, I believe the administration is being politically naive. I do not believe the American people will stand by idly and let the oil prices triple to $98 a barrel in the middle of a world oil crisis. That would be chaos.

The American people will demand action. And I believe we have the responsibility to plan for that action today.

I have many questions of our witnesses today, both with regard to the real world problems and with regard to the mock test that the U.S. participated in.

As you know, I am particularly concerned with the antitrust exemptions in current law. That exemption allows the world's major oil companies to sit down at a table in a time of major shortages and agree to allocate the world's oil supplies.

To say the least, I don't trust that.

Now Senator McClure has introduced legislation S. 1678, that would allow private interests--including the major oil companies--to sit down and establish so-called voluntary agreements and plans of action.

They would be allowed to do so with complete immunity from antitrust laws. And they would be exempted from all federal conflict of iterest laws.

This is nothing short of turning our country over to the oil companies in the time of a major oil shortage.

Mr. Chairman, I have many questions and concerns about this bill. Again, I don't think the American people will stand for it.

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The **Chairman**. Obviously, the debate is open. This isn't necessarily the time for the Senator from Idaho to debate with the Senator from Ohio. Let me say just in response, as he did in his opening, that we find differences of opinion here. Those will be aired.

With respect to the U.S. participation in the IEA, we will discuss that matter. While that's not the sole purpose of these hearings, that's included in the subject matter of these hearings. We have witnesses before us who will address those questions, and the Senator from Ohio can address whatever questions he wishes with respect to that policy question and our participation in the IEA.

I would hope that that will be sufficient. If indeed it is not, then we'll address that question when we get to that point.

Senator Hecht.

Senator **Hecht**. Thank you, Mr. Chairman. I feel there have been enough opening remarks, so let's hear the witnesses.

The **Chairman**. I thank the Senator from Nevada.

The Chair recognizes Senator Matsunaga.

Senator **Matsunaga**. Thank you, Mr. Chairman.

STATEMENT OF HON. SPARK M. MATSUNAGA, A U.S. SENATOR FROM THE STATE OF HAWAII

Senator **Matsunaga**. Mr. Chairman, let me at the very outset congratulate you on your success in achieving some movement on the part of the executive branch toward preparing for an energy emergency.

But I am convinced that the "elements of agreement," whereby the administration would fund completion of the strategic petroleum reserve fall far short of an adequate national response to an oil import cut off.

This month marks 10 years since the Arabian oil embargo of 1973. Yet, the morning newspaper headlines on the Iraqi-Iranian war bring an unsettling sense of deja vu. The prospect of a Persian Gulf petroleum supply disruption is real and imminent.

We must view this bill, and the agreement it represents, in the light of our past experience and make a decision whether they adequately meet the dimensions of likely crises ahead of us.

In my judgment, they do not.

With all due respect, Mr. Chairman, I must say that this bill, S. 1678, only plays lipservice to the concept of regional storage articulated in the original legislation but never fully implemented by the executive.

In fact, by lowering the fill rate, S. 1678 has the effect of releasing pressure for the cogency of interim storage and, by extension, regional storage.

In the recent International Energy Agency simulation exercise we witnessed the graphic results of the administration's tunnel vision reliance on the efficacy of market forces to see this Nation through an oil import cut off or whatever duration.

The contortions the energy emergency preparedness staff at the Department of Energy went through to HEW faithfully to the administration line, against all real world odds, would be laughable if the purpose of this oil video game were not so serious and the prospect it envisions did not appear so immediate.

The disarray it caused among participants—oil companies, manufacturers, farmer cooperatives, 10 States of the Union, other sovereign nations and allies—have been attested to in hearings last month in the House.

But Mr. Vaughan's office proclaimed triumph for the administration's laissez-faire policy toward preparedness—and when pressed for the evidence, weakly fell back on the excuse that decisionmaking processes and coordinating mechanisms somehow functioned.

But to what effect, pray tell? According to the most dispassionate witnesses whose testimony I read, if the operation was a success the patient was nonetheless dead.

Success, like beauty, must be in the eye of the beholder. No one else in the State Department, in the International Affairs Office of their own department, seemed to share Messrs. Vaughan and Winler's vision.

Here we have a repeat of the recent Regan-Feldstein flare up. When a member of the administration points out the lack of policy garments on the Emperor's frame, he is the one that is muzzled, not the courtier who proclaims his triumphant advance.

Let me relate only one incident in that exercise-travesty, Mr. Chairman, because it points up the necessity of addressing the regional storage issue.

I quote from the House testimony of Deputy State Energy Commissioner Charles Guinn of New York:

> DOE's belief was that residual fuel from the West Coast should be available for New York's use at market prices. DOE, however, overlooked the reality that residual oil is not shipped normally from coast-to-coast and that no transportation mode other than ocean-going tankers exist to achieve this transfer. . . .
>
> The Federal Government was unable to detect the supply shortage early and was unable to intervene and divert petroleum products from nearby areas or alert major suppliers to redirect product from the high seas.
>
> We believe that this problem could have been avoided altogether if a regional petroleum reserve program had been in effect.

Mr. Chairman, my State—Hawaii—is far more vulnerable to an oil embargo than New York or Maine or any New England State. We are almost totally dependent on imported oil for our energy requirements and will be for some time to come.

It is not clear to us what would happen in an emergency if sole reliance is placed on market forces, especially since all of Hawaii's oil supply resources must be shipped in from distant areas.

What is clear is that, in the absence of a change in Federal policy, the strategic petroleum reserve represents just about the entire Federal Government's emergency response capability. And the logistics of the SPR's placement puts it beyond Hawaii's reach in an emergency.

I fear that the underlying assumptions of the administration's position may be in serious error, Mr. Chairman. While only 30 percent of U.S. oil imports today come from OPEC nations, compared with 50 percent in 1973, a Congressional Research Service examination issued this year concludes that in the short term we could suffer economically from a Persian Gulf disruption in the same approximate range as would our allies in Western Europe and Japan.

It has been said that "those who forget the past are doomed to repeat their mistakes," Mr. Chairman. Last year, Argonne National Laboratory submitted a report to the Energy Department on an energy emergency's impact on freight carriers. It pointed up the fact that, under deregulation in the trucking industry, we are much more dependent upon independent, small trucking operators today than we were back in 1979 when the Iranian Revolution curtailed fuel supplies, especially those distributed through truck stops in isolated areas. Those truck stops are even more important today in the overall distribution picture than they were then.

I suggest we go back and try again to reach an understanding with the administration whereby their ideology is tempered by some of the "realities" encountered in the recent IEA exercises.

It is unsettling to me when Capitol Hill lobbyists for some of the largest petroleum distributors in the world tell us they don't want the entire responsibility for energy allocation the next time around.

That is why they have gone around to the State legislatures urging those lawmakers to pass set-aside legislation "as a social safety valve" to complement "market forces."

But what are we doing in S. 1768, Mr. Chairman? We are hamstringing the very level of Government that will fill the leadership void the next time around. We are telling them "hold everything for 10 days until the Federal Government, which has opted out of any active role in the situation, passes judgment on your particular circumstances."

I don't think that would be especially helpful, Mr. Chairman.

I believe it is the proper role of the Federal Government to provide the necessary leadership to reestablish ourselves as an energy self-sufficient Nation. Energy is all-pervasive to the functioning of our economy, and so long as we are dependent upon foreign sources of supply we shall never be able fully and effectively to control our own economic destiny.

Our economic ills today have their origins in the traumatic soaring of the price of imported petroleum accomplished in the last decade, by the Organization of Petroleum Exporting Countries.

For the first time in our recent history, the United States is running massive trade deficits which would change into substantial surpluses if we could but cut the cost of our oil imports in half.

To do this, the Federal Government must work with the private sector to develop those of our indigenous energy sources that otherwise would not be developed, or developed as quickly. It doesn't mean abdicating virtually all responsibility to the private sector in an oil cutoff emergency.

Moreover, in its responsibility for an overriding public interest, Government should act to assure continuity of supply; in the short term this means stockpiling reserves to bridge emergency cutoffs until the day we are self-sufficient in energy.

We must hold the administration to account, despite their philosophic reluctance, so that all of us—oil companies, farmers, consumers, the poor, and elderly living in harsh climes—can receive some assurance that in a pinch, Uncle Sam will exercise that necessary leadership.

I might conclude, Mr. Chairman, by repeating that I believe that it is the proper role of the Federal Government to provide the necessary leadership to reestablish ourselves as an energy self-sufficient nation.

Energy is all-pervasive to the functioning of our economy, and so long as we are dependent upon foreign sources of supply, we shall never be able fully and effectively to control our own economic destiny.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator.

The next two witnesses are familiar figures before this committee on these subjects. I welcome their participation in the past and again in the present. We have the Honorable Dave Durenberger, U.S. Senator from Minnesota, and a man who is no stranger either to this committee or to these issues, the Honorable Mark Andrews, again addressing questions with respect to the emergency responses of this country.

Your contributions have been immense in the past and I expect they still will be. Minnesota and North Dakota have somewhat similar interests in many regards in this area and it's not at all surprising that the two Senators from those two States would be here this morning.

With that, I recognize Senator Durenberger.

STATEMENT OF HON. DAVID DURENBERGER, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator DURENBERGER. Thank you very much, Mr. Chairman. Ten years ago I was in a glue factory and you and my junior colleague here from North Dakota are responsible for our public policy, so I come here to wash my hands of the responsibility for celebrating an anniversary. But it isn't the first time that Mark and I have sat in these chairs to discuss this subject with you. I think in the summer of 1981, when we were coming off the 1979 crisis and into a new administration, we were the lead witnesses at a hearing that you conducted on the Standby Petroleum Allocation Act. We had joined with 14 other, primarily Midwestern, Senators to sponsor similar legislation, the Petroleum Disruption Management Act.

We had the great pleasure of working under your leadership, Mr. Chairman, as concepts in those two bills were joined and to watch you skillfully maneuver the package through the legislative process. We are back, of course, because the President of the United States ultimately vetoed the bill, and the Senate, for reasons largely unrelated, as I recall, to the content of the bill, at least, hopefully, sustained his judgment.

We're back with roughly the same message. The country still remains largely unprepared to meet the demands and prevent the havoc of oil distribution. I would disagree with my colleague from Ohio in one respect. Things aren't really all that bad today compared to 2 years ago. We have taken one important stride toward preparedness. We have a lot more oil in the strategic petroleum reserve—over 350 million barrels today, I believe, and for that we can largely be thankful to you, Mr. Chairman, and the members of this committee and to the administration for its determination to make progress in filling SPR.

If we figure the price of oil at roughly $30 per barrel, we now have invested slightly more than $10 billion in the oil domes of

SPR. And that is a substantial commitment by any yardstick. It's a good insurance policy, most of us would think. But, Mr. Chairman, an insurance policy, however high the premium, just isn't any good unless you can collect on it when you need it. And it's in this respect, that is, how and when to use the SPR if we need to, that I still believe that the preparedness plans of this Government are wrongheaded and sure to plunge us into panic markets if events again turn for the worse in the Mideast.

To be sure, the administration has issued a drawdown plan as the committee required. But it's a plan that doesn't tell us when SPR oil will be used, for what purposes it will be used, and how rapidly it will be used. All we know is that this $10 billion insurance policy is going to be sold off to the highest bidder when the President decides it should be.

I have many times tried to convince the Senate and the administration that this policy of selling the public's oil to the highest bidder during a crisis can't work, would not be accepted by the American public. Suppose the highest bidder is a foreign nation, perhaps even a current oil producer. Would the American public watch placidly from the gas lines while their oil is shipped to a foreign nation?

Or suppose the highest bidder resells the oil for substantial profit in a rapidly escalating market or suppose he hoards it hoping that prices will go even higher? Will farmers with crops rotting in the fields believe that the market-based approach is successful because some put a higher value on hoarding oil than they do on harvesting crops?

As I say, Mr. Chairman, we have reviewed these arguments here and on the floor many, many times. But there is one piece of new evidence that we can consider today, and you indicated in your statement that you intend to, and that's the so-called AST-4 study led by the IEA and the Department of Energy when it produced a simulated economic disaster, and the administration's market-based approach in that case was pushed to the limit.

Under disruption parameters set out by the IEA, DOE chose not to use SPR oil in this simulation despite the fact that oil prices climbed to $98 per barrel. While State government agencies and foreign nations participating in the simulation saw disaster on all sides, a spokesman for DOE calmly dismissed $98 a barrel with the following words: "This is a significant achievement and reaffirms the validity of President Reagan's market-based approach to energy emergencies."

That, Mr. Chairman, is a crock. I cannot believe that the American public will ever agree that the overnight tripling of oil prices in a real crisis is a significant achievement by any measurement by any President. We've been down that path twice already and the legacy of economic ruin that has resulted is the farthest thing from achievement.

The achievement is the perseverance we have shown in filling the reserve despite difficult budget problems on every other front. It is in the light of that achievement that we, all of us, must view the results of the recent AST-4 study as the worst kind of a failure. The oil wasn't sold to the highest bidder, it didn't get exported, and it wasn't hoarded for a profit. It got left in the ground while a simulated economy was once again falling apart.

So, Mr. Chairman, I hope you are ready to try one more time. I know you are. I am encouraged by this hearing and by the legislation that you've introduced. Mark Andrews and I once again stand ready to assist your efforts in any way we can. Later this week we're going to be introducing legislation again based on the same principles that guided us in writing the Petroleum Disruption Management Act. That is:

First, the SPR should be used early in a crisis to prevent the rapid run up in oil prices that becomes permanent.

Second, that oil should only be sold to those who will refine it domestically and get it to the marketplace as product in a reasonable period of time.

Third, the price for that oil should not reflect the panic of the spot market but the underlying price of oil before the disruption.

Fourth, that when necessary crude oil supply from the SPR should be targeted to ease regional supply imbalances and keep essential industries operating.

Fifth, that a consensus on a workable drawdown policy be established now so that domestic refiners can count on it as they plan production and inventories and so that Congress can largely stay out of the oil business, if and when another crisis is experienced.

So, Mr. Chairman, I've said it many times, but there is a role for government in the petroleum marketplace. During good times when prices are stable or falling, private sector inventories are cut. At the beginning of a crisis they are rebuilt rapidly with skyrocketing prices.

This business cycle does not serve the public interest in the case of a commodity so essential as oil. To counter it we have wisely invested $10 billion in the strategic petroleum reserve. We need only go one more step in our effort to be prepared, and that is to plan now to use the oil wisely should another crisis occur.

I thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Andrews.

Senator ANDREWS. I appreciate the opportunity to be here, Mr. Chairman. Let me summarize my statement, because I heard that long bell.

The CHAIRMAN. Your entire statement will be placed in the record in full.

STATEMENT OF HON. MARK ANDREWS, A U.S. SENATOR FROM THE STATE OF NORTH DAKOTA

Senator ANDREWS. Frankly, the reason Dave and I are here is that we represent an agricultural area that's at the end of the supply line, so to speak. When those blue-eyed Arabs to the north, our Canadian friends, have a little shortage themselves, the oil that normally comes in from their country to supply our area becomes nonexistent. So we have here the heartland of America's farm production at the far end of the energy pipeline in a case where losing energy for a critical 2-week period on the farm, if that diesel fuel isn't there, you lose a whole year's crop. Plus the fact, I think, that our colleagues ought to realize that at the time we had the Arab oil embargo and the Iranian revolution, we have seen fuel costs on the farm increase by $5 billion since that point in time. Compare that with a total net income from agriculture of $20 billion. Fuel costs have taken one-fourth of agriculture's net income. So there is an amazing buildup.

And that all impacts on the consumer, I might add, Mr. Chairman. Certainly we have to do something to make sure the people are aware of the situation.

I've looked at the plans developed by the Department of Energy, including the strategic petroleum reserve drawdown plan, and to put it mildly, I'm not pleased. I share the feeling of my colleague, and I won't describe in barnyard terms what it is, but I think he did pretty well. The existing plan is not what I envisioned and would result from flexible authorities which, after extensive efforts, we provided to DOE upon passage of the Energy Emergency Preparedness Act. The drawdown plan just doesn't get the job done. Commonsense tells me that the SPR can be used to offset shortages and reduce oil price pressures. You can deal with the root of the problem, treating a crude oil shortage, by supplying crude oil to the refineries which have been serving the marketplace all along. That's what ought to be done and it ought to be done early on. Particular attention should be taken to those refineries that have no other source of energy and those refineries that are, in fact, supply agriculture, which has a time certain deadline.

I think what we have to do is to make sure that we have in place a mechanism that's ready if called upon to distribute crude oil to domestic refiners that have lost supplies. I think we ought to monitor the disruption closely. If shortages develop or prices move up quickly, then move SPR oil into the system fast. It would be a terrible and unnecessary waste if we stood by and left the stuff in the ground while farmers couldn't get fuel and prices doubled or tripled and the commodities just weren't there that we need. Not just to take care of our own consumers need, but the export for those dollars overseas that help us to pay for the imports.

My colleague and I have joined forces in attempting to capture this commonsense approach to dealing with emergencies. The bill that we will be introducing later this week reflects the end result. We know that our bill is far from perfect, but we do offer it, Mr. Chairman, and members of the committee, as an approach that can work. I can't say the same for the present SPR drawdown plan.

We appreciate very much your understanding and your hospitality to those of us who are the Minnesota and North Dakota twins up there.

[The prepared statement of Senator Andrews follows:]

PREPARED STATEMENT OF HON. MARK ANDREWS, A U.S. SENATOR FROM THE STATE OF NORTH DAKOTA

Mr. Chairman and Members of the Committee, I am pleased to have this opportunity to share with you my views concerning a vital issue in which I have long been involved: Developing our preparedness capabilities to a level at which we can respond effectively to the adverse impacts generated by dramatic oil shortages. While I intend to address this problem first and foremost on behalf of American agriculture, I am firmly convinced that our overall national and economic security are at stake.

Mr. Chairman, I am pleased that you share my concerns regarding present policy, as evidenced by your introduction of S. 1687 and the scheduling of today's hearing. I commend you for your leadership.

As I am sure you all know, I am a farmer and proud of it. My father and grandfather were before me, and now my son is carrying on this proud tradition. I am here representing what is probably the most agricultural state in the country--at least as measured in terms of North Dakota's annual gross income generation. To put it mildly, I have a keen interest in assuring a dependable supply of petroleum products for agriculture. My rural constituents lie at the end of the petroleum distribution system, and are hit first and hardest by shortages. With major oil companies continuing to pull out of rural markets, farmers are increasingly dependent upon farmer cooperatives and other independent refiners for their fuel needs. Mr. Chairman, I know that you also have a strong agricultural and rural base in the great state of Idaho, and share similar experiences and concerns as a result of past oil emergencies.

We cannot afford a disruption, even of short duration, at the wrong time. We could experience crop losses or sharply reduced yields, for an entire year. For example, USDA data indicate that crop losses caused by a 10 percent fuel shortage could lead to an increase in commodity prices of more than 50 percent. While I might welcome this as a farmer, if I were lucky enough to get fuel, this is not a good basis for forcing higher prices on the consumer.

The shortage is the immediate problem which faces us, and we all remember gasoline lines. But the price increases which follow a shortage tend to say with us. Farmers' fuel costs increased by $5 billion annually following the Iranian Revolution. Compare this with net farm income of under $20 billion. In addition, a doubling of energy costs can permanently raise food prices by 12 percent, or about $30 billion annually. While in the short term the farmer, as a "price taker" in the truest sense, might temporarily absorb such a cost increase, it could push many family farms out of business.

Iraq now has an Exocet missile system. Iran is threatening to shut down the Straits of Hormuz. We have troops in Lebanon. These events make me wonder about just what kind of preparedness we have for a disruption in the Middle East, and how essential energy needs here at home will be met.

I have taken a hard look at plans developed by the Department of Energy, including the Strategic Petroleum Reserve Drawdown Plan. To put it mildly, I am not pleased. Certainly, the existing plan is not what I envisioned would result from the flexible authorities which, after extensive efforts, we provided to DOE upon passage of the Energy Emergency Preparedness Act of 1982. In particular, the new SPR Drawdown Plan just doesn't get the job done.

Mr. Chairman, if I have to, I am prepared to take the "bull by the horns" and fight with every resource at my disposal to see that sufficient fuel supplies are allocated to a central agricultural operation, should they experience shortages during the next disruption. There could be no greater disaster for the American consumer and the economy than an interruption in food supplies.

However, I don't think such action is necessary. Or at least it shouldn't be. Not because I have blind faith in the "free market." We have seen that normal market forces break down during the panic conditions created by a shortage. But rather common sense tells me that the SPR can be used to offset shortages and reduce oil price pressures. You can deal with the root of the problem--treating a crude oil shortage by supplying crude oil to the refineries which have been serving the marketplace all along. This gives Uncle Sam just enough leeway to do the right thing, without getting so involved that we succeed in making the problem worse.

Now, I have taken a hard look at the way DOE proposes to use the SPR. I don't see any evidence that they intend to make supplies available early, before things get out of hand. And, I am appalled by the notion of auctioning SPR oil to all comers. Why, even those who caused the shortages in the first place could bid!

Mr. Chairman, if we allow this approach to remain in place, the Congress will find a real mess thrown right in its lap in the event of another disruption. Our efforts to avoid a repeat of past mistakes will have been tragically wasted.

There is a much better way to go about using the SPR. Why not have in place a mechanism which is ready if called upon to distribute crude oil to domestic refiners which have lost supplies? Provide the SPR oil at prices indicative more of normal market conditions, rather than allowing panic to drive prices up for the benefit of oil producers. Then, make sure the oil isn't hoarded, or used to enrich speculators.

Monitor the disruption closely. If shortages develop or prices move up quickly, then move SPR oil into the system--fast. It would be a terrible and unnecessary waste if we stood by and left the darn stuff in the ground, while farmers couldn't get fuel and priced doubled or even tripled. The recent AST-4 Test shows us that this could happen.

The kind of insurance program I have jsut sketched would generally allow the petroleum industry to do its job, except under the most severe shortages. Any problems which remain at the local level could best be treated by states through a set-aside.

My colleague and friend from Minnesota, Senator Durenberger, and I have joined forces in attempting to capture this common sense approach to dealing with oil emergencies. The bill which we will be introducing later this week reflects the end result. We know that our bill is far from perfect. But we do offer it to Members of your Committee as an approach which can work. I cannot say the same for the present SPR Drawdown Plan.

Mr. Chairman, I appreciate the opportunity to appear before this Committee, and I stand ready to work with you and our colleagues toward developing a sound and workable SPR drawdown policy.

The **Chairman**. Thank you very much for your testimony. I might just ask one question. I'm mindful, too, of the fact that there is a vote now underway on the floor of the Senate that will necessarily interrupt us. I assume that you would like to be excused before we go to that vote rather than come back for further comments or questions, but you're certainly welcome to come back.

With regard to the question of the SPRO drawdown plan, the publication of the plan in advance, and its effect upon the willingness or determination of those who are in the marketplace to take their own steps to deal with inventory shortages. It is argued that if indeed we are too specific in the plan and DOE does deal in their plans with surety, that with the knowledge that they can draw upon SPRO, they'll not take those steps necessary to guarantee their own supply.

I draw one parallel. Cities and school districts, in particular, buying energy supplies go to the market and they get the lowest possible price and those are, generally speaking, contracts that don't guarantee delivery. Then when a shortage occurs, they want Government to guarantee the delivery even though they've had the benefit of a pricing policy that was based upon interruptability.

How do we meet that problem of making certain that we don't send the signal to them that they need not take their own steps while at the same time guaranteeing to them that we will be in a position to respond when they need help?

Senator **Durenberger**. Well, I think, Mr. Chairman, the question raises the common test of whether the marketplace will work with some Government involvement. I think the argument that we have always made on behalf of planning in advance is not that we are going to dictate the way the marketplace is going to operate but that the marketplace, knowing the way that we are going to operate in the event of a crisis, will adjust to that predictability. I don't think that we would be dictating in a plan other than some of the things that were commented on here in terms of regional issues, and so forth, we're going to be dictating either price or supply. But we are going to predict in advance what action we will take with regard to SPRO.

On the basis of that predictability, the marketplace will have the right kind of incentives in terms of price and allocation of owned supply to react in a way that doesn't do the artificial thing that I talked about in my statement, which is hoarding or something else.

Senator **Andrews**. Well, Mr. Chairman, you pointed out one instance, the instance of the school board that buys the lowest bid, and we know why that happens. There's another instance, as well, in supplying the fuel, and that's the farmer co-ops and the bulk oil plants out there that get from the independent or cooperative refineries their supply. Now they're not the low buck, low bid. That's the only unit that supplies petroleum in that area. The big ones have pulled out of our area. They've gone off to other pastures. They have alternate supplies. The farmer co-op refinery, the small independent refinery often doesn't have the ability to protect themselves to cover their rear in times of emergency, as you're suggesting. That's why we have to have a Government plan that recognizes the difference between those refineries of those oil companies that can protect their rear and those that simply can't. That's what I would hope we would see.

The **Chairman**. I know we're about to run out of time and I don't mean to dominate, but I do know that the independent refineries have, in light of the shortages induced in 1973, 1974, and again in 1979, taken steps to assure them of more supply. They've invested money in exploration and development, and they've entered into contracts for increased supply.

The argument on the other side is if, indeed, we tell them they don't have to do that, they won't make those investments. That's the reason for the question, whether they have some responsibility for themselves in that marketplace. I don't know exactly where the crossover point lies in this policy question. Senator Metzenbaum.

Senator **Metzenbaum**. Either of the Senators, I think we're in general agreement that your legislation moves in the direction that I think our Nation ought to go, and I have no problem at all about providing a priority allocation for farmers. I do have concerns, however, where in the past the battle that we had on the floor of the Senate had to do with whether the priority for farmers also included the candymakers, the cat and dog foodmakers, those who were in the alcohol industry, and even plywood.

In your pending proposed legislation do you have just a broad, general definition of agriculture priority?

Senator **Andrews**. We anticipate, might I assure my colleague, that it should be to the processor of those perishable farm commodities—the sugar beet plant, not the candy factory, the sugar beet plant because if you don't process those commodities when they're fresh they spoil. The potato plant because those potatoes are a perishable commodity. These kinds of vegetable canneries, because if you don't get the string beans out of the field and into the can in a 2-day period, you don't have quality. These are the agricultural processing companies that we would say should have priority. The dog food and the pet food and the other manufacturers, they can stop their cycle for a 2- or 3-month period without bothering the quality of what they're processing.

Senator **Metzenbaum**. Do you have this spelled out in your legislative proposal?

Senator **Andrews**. Yes.

Senator **Metzenbaum**. What would happen to the liquor producers, beer, liquor?

Senator **Andrews**. Well, theirs is a long-term process, might I assure the Senator. I understand that stuff sits in oak casts for 4 or 5 years and it takes quite a while.

Senator **Metzenbaum**. Well, I would hope that you would attend to that because I think——

Senator **Andrews**. I think you understand what we're driving at. The processing of perishable farm commodities has to have a unique priority status.

Senator **Metzenbaum**. It's just limited to them?

Senator **Andrews**. Yes.

The **Chairman**. I'm sorry that we're constrained as we are by votes on the floor. We'll stand in recess pending call of the Chair.

[Whereupon, at 10:50 a.m. the hearing recessed to reconvene at the call of the Chair.]

The **CHAIRMAN**. Next we will hear from the administration in the person of Mr. William A. Vaughan, Assistant Secretary for Environmental Protection, Safety, and Emergency Preparedness, and Mr. E. Allan Wendt, Deputy Assistant Secretary for International Energy Policy of the Department of State.

We hear first from Secretary Vaughan.

STATEMENT OF WILLIAM A. VAUGHAN, ASSISTANT SECRETARY FOR ENVIRONMENTAL PROTECTION, SAFETY, AND EMERGENCY PREPAREDNESS, DEPARTMENT OF ENERGY, ACCOMPANIED BY E. ALLAN WENDT, DEPUTY ASSISTANT SECRETARY OF STATE FOR INTERNATIONAL ENERGY POLICY, DEPARTMENT OF STATE

Mr. **VAUGHAN**. Mr. Chairman and members of the committee, I appreciate the opportunity to discuss with you energy emergency preparedness in general, and specifically the Department of Energy's position on S. 1678, the Energy Emergency Preparedness Act Amendments of 1983.

I would also like to submit for the record a document which elaborates the views of the administration on S. 1678, and request that it be included in the record.

The **CHAIRMAN**. It will be placed in the record in full following your statement.

Mr. **VAUGHAN**. U.S. participation in a world market for energy resources, particularly petroleum, demands that a high priority be placed on domestic energy policies and programs in the areas of national and international energy security.

Administration energy emergency preparedness policy places primary reliance on the marketplace to repond to disruptions in energy supplies.

But this does not mean that there is no role for the Federal Government in the field of energy emergencies. Federal programs that focus directly on our preparedness for an energy emergency include the development and continued expansion of the strategic petroleum reserve, now nearly a half filled, with, as of this morning, over 365 million barrels of crude oil, emergency response planning, and periodic tests of our ability to respond to a wide range of possible energy emergencies.

To complement Federal efforts, the marketplace also is supplemented by programs such as the national defense executive reserves, which draw on the expertise of individuals in private industry.

Preparedness, in our view, is a state of constant readiness, which by its very nature can never be static. While we feel confident that our energy emergency preparedness program is an effective one, we also know that improvements and enhancements are always possible, and we look forward to continuing communication with this committee to develop these improvements.

Internationally, an important part of our energy emergency preparedness program is the U.S. continuing commitment to the International Energy Agency.

We are not unmindful of the interdependence of our energy security with that of the rest of the free world. As the President's fourth national energy policy plan, issued October 4 of this year stated—and I quote:

> The United States will maintain its strong commitment to the International Energy Program and the IEA oil emergency system; and will continue its support of IEA programs to remove market impediments, accelerate the development of new technologies, increase energy efficiency, and strengthen emergency preparedness.

Since 1974, the United States has participated with 20 other countries in the International Energy Agency, in an effort to improve our effectiveness in responding to international energy problems.

The administration believes that a coordinated response to any international oil supply disruption through the IEA requires cooperation by private U.S. oil companies in ways that are not possible without statutory authorization.

Participating U.S. oil companies recently received antitrust protection for their activities in connection with the fourth in a series of periodically scheduled tests of the IEA emergency oil allocation system, known as AST-4.

Because of the committee's interest in this test, I will describe briefly the purpose of the test and highlight some of the issues raised during the exercise.

Generally similar in scope to previous IEA tests, AST-4 did not involve the actual redirection of any oil or the actual implementation of any emergency programs in any of the IEA member countries.

The exercise was designed primarily to train participants—that is, both Government and private industry—on what their responsibilities in a real emergency would be under the IEA emergency oil allocation system.

We believe that the test was a valuable training opportunity. For example, AST-4 was the first exercise of this type that included those U.S. companies, the so-called nonreporting companies, that do not participate directly in IEA activities under the statutory antitrust protection provided by section 252(f) of the Energy Policy and Conservation Act.

Following the completion of AST-4, the DOE prepared and recently submitted to the IEA its evaluation of the exercise. We noted in the report a number of data and procedural issues that warrant further analysis. Also, the report noted that two so-called fairsharing type options were identified in AST-4:

First, drawdown of the strategic petroleum reserve so that companies which successfully bid on SPR oil would be encouraged to make voluntary offers, with the additional option of directing up to 10 percent of the volumes drawn down to specific companies; and

Second, implementing a system of directed supply orders to various companies on a fair and equitable basis, to insure that the burden of participating in the international energy program was not borne disproportionately by any one company or group of companies.

Consistent with administration policy, we are open to consideration of other fairsharing options that might be appropriate. We are continuing to work on the fairsharing options already identified that I just enumerated.

The United States continues to support revision of the IEA emergency management manual to eliminate the outdated reference to term pricing in its definition of comparable commercial transactions, a phrase which appears in the agreement on an international energy program, and which provides the basis for pricing internationally allocated oil.

This revision is a key recommendation in the IEA group of experts' appraisal report on AST–4. IEA member governments recognize that the language developed in the past decade may not be relevant to current market conditions and that the current language could inhibit effective operation of the voluntary offer system in an actual emergency. Discussion is underway to revise the manual.

In addition, the Department itself has begun revising its internal operating manuals to reflect lessons learned in the AST–4 exercise, and these manuals will be further revised upon establishment of any new procedures in the IEA in connection with the initiatives previously noted.

Although the postexercise evaluation process is continuing, let me say that from the U.S. perspective, the exercise was successful in accomplishing the exercise objectives and furthered our energy emergency preparedness planning in that respect.

Another recently concluded test was the distribution readiness exercise B, so-called direx-B, which tested the Department's procedural and managerial readiness for drawing down the SPR in the event of a severe supply disruption.

The exercise, which included staff and senior management involvement, met the major objective of identifying areas for further study and refinement.

For example, it became obvious that the draft standard sales provisions being developed for SPR oil sales need to provide much greater flexibility and compatibility with industry practices.

We are already revising the SSP's based upon comments received from the concurrent public notice process, and from the experience we derived in direx-B. Additional procedures and policy determinations will also be pursued in the key decisionmaking and operational areas.

A valuable feature of direx-B was the establishment of an independent assessment team drawn from both the public and private sectors. The team has identified a number of key issues in SPR decisionmaking, sales, and operations. I look forward to their final report, which they expect to complete and deliver to us in early November.

The exercise proved to be a useful opportunity to evaluate the effectiveness of existing procedures for managing and directing an SPR system response to an energy emergency.

The issues identified by DOE and the assessment team will be considered in defining and prioritizing follow-on actions to insure the successful distribution of SPR oil supplies during an actual energy emergency.

The lessons learned from exercises like AST–4 and direx-B have enabled us to strengthen our energy emergency preparedness program substantially, and I welcome the opportunity to work with this committee through vehicles like S. 1678 to improve our program even more.

Let me discuss in more detail DOE's position on this bill, S. 1678. In general, the administration supports and encourages legislative efforts to address the energy emergency preparedness issues which are the subject of this bill.

As discussed by both Budget Director Stockman and Secretary Hodel in their letters of July 19, 1983, this administration shares with you a strong commitment to insure that the Nation's energy emergency preparedness response capability is adequate to safeguard the national security and to deal with energy supply disruptions.

As I have already indicated, the administration is strongly committed to utilizing the assistance of the private sector, including the energy emergency executive reserves and, as necessary, voluntary agreements, as an integral part of our domestic and our international energy emergency preparedness program for both an actual or potential emergency.

The executive reserve organizations can provide the needed cadre of industrial experts to assist Government managers in times of national peril.

Three crucial units of the national defense executive reserve would bring together experts in petroleum and gas, solid fuels, and electric power.

It has never been the administration's intention to activate the NDER units for purely regional or local emergencies, such as snowstorms, local distribution outages, or local strikes. The reservists would be activated only in energy emergencies of national or international character.

Possibly the most important point in support of the executive reserves is that their role is to help facilitate the operations of the marketplace during times of severe national stress. We have seen the consequences of Government regulations, imposed in response to the oil crisis of 1973. Not only did these regulations fail to resolve the immediate problems effectively, they perpetuated and compounded those very problems.

The President's comprehensive energy emergency response procedures report also contemplates the use of voluntary agreements as a method of involving the private sector in the response to severe energy emergencies.

It concludes that a general review of existing authority for voluntary agreements is in order, and that consideration should be given to legislation removing existing limitations in current law.

The administration wants to be sure that existing conflict of interest and antitrust laws do not serve as a significant deterrent to private sector participation in the reserves.

The Department of Energy has received substantial indications from the private sector of a perceived inability to comply fully with these laws, despite the best of efforts.

Underlying this perception is an apprehension that good-faith actions, taken by participants in an effort to assist the Federal Government in dealing with actual or prospective energy emergencies, may result in civil or criminal litigation or even in liability.

Whether this apprehension is justified or not, those laws should not preclude effective use of standby executive reserves or appropriate voluntary agreements that could be so important to the Nation in future times of crisis.

We applaud the efforts of the chairman and the committee in attempting to provide broader and more flexible authority for the use of DOE's executive reserve organizations and of voluntary agreements and plans of action.

In order that the United States will have the capability to respond effectively to future energy supply disruptions, we support appropriately drawn legislation in the areas of conflict of interest, and antitrust.

At the same time, the administration believes it is important to assure that legislation intended to ameliorate the existing problems does not create a situation which lends itself to abuse.

Consequently, we believe that revision of the proposed sections 273 and 274 is necessary to narrow the relief proposed.

For example, the waiver authority with respect to conflict of interest laws in proposed section 273 should, in our view, be revised in such a manner as to tailor it to the impediments to industry's participation in executive reserve organizations, rather than be granted on a blanket basis.

With respect to the proposed section 273 authority to waive applicability of the antitrust laws in connection with executive reserve organizations, it would seem sufficient, for example, to overcome the justified apprehensions of industry if this waiver were limited to those actions of Government employees or consultants which are taken in good faith within the scope of their authority.

Some limitation on the availability of section 274, providing an antitrust defense to participants in voluntary agreements or plans of action, is also called for.

In the administration's view, it should be made clear, among other things, that the benefit of the antitrust defense would be enjoyed only when and to the extent that the participants are carrying out tasks at the request of the President.

Mr. Chairman, I am authorized to assure you that both the Department of Energy and the Department of Justice stand ready to work with the committee in revising those sections along these lines or, for that matter, any others which would assure that the necessary corrective legislation is not written in a manner which results in abuse or unintended consequences.

The administration strongly supports section 4 of the bill which would extend to June 30, 1985, the antitrust defense afforded by section 252(f) of EPCA to U.S. oil companies participating in implementing the agreement on an international energy program.

The antitrust defense made available by section 252(f) is essential, in our judgment, to the participation of U.S. oil companies in the voluntary agreement and, through it, in the international energy program.

The international energy program, in turn, can function effectively only with participation by United States and foreign oil companies which are primary sources of information about conditions in the international oil market, and they would be the primary factors in redistributing oil if the IEP's emergency sharing provisions were activated.

Mr. Chairman, I would also like to comment on the subject of a test sale of SPR oil. I believe that certain benefits could be achieved through such a test sale, primarily developing public confidence that SPR oil could be drawn down, delivered to industry, and processed in refineries.

However, selling a limited quantity of SPR crude oil under stable market conditions would not realistically test the competitive sales process and delivery scheduling in the same type of environment as would exist during a real supply interruption.

We plan to analyze the merits of such a test before we reach a final decision on actual conduct of such a test.

The administration is concerned about the approach this bill takes to the subject of preemption of State and local laws dealing with the pricing and allocation of petroleum products.

We are cognizant of the concerns that have been voiced that State and local laws could, at some point, aggravate an oil supply disruption before steps were taken to confine them to their proper constitutional scope.

We believe a balanced approach would be to empower the President to preempt only those laws and regulations which require preemption, if during a declared energy emergency of national or international character the President concludes that State or local laws are, in fact, interfering with the domestic marketplace to aggravate the emergency and that they unduly burden interstate commerce.

The enclosed document presenting the views of the administration suggests a substitute provision along these lines.

Petroleum inventories provide part of the available protection against an oil supply interruption, along with the operations of the marketplace and the strategic petroleum reserve.

Depending on the specific circumstances at the time of the disruption, the private sector can decide how best to use its own resources.

Fundamentally, there is no basis for making all supplies of fuel available to be consumed as soon as possible. Cautious inventory management may well be the prudent course of action. We believe neither the Federal nor State governments should substitute their judgment for the collective judgment of the private sector as to how the private sector utilizes its own supplies of fuel.

Section 7 requires a number of reports describing implementation activities on a broad range of emergency preparedness topics, including an update on the President's comprehensive energy emergency response procedures report.

As I mentioned earlier in my testimony, energy emergency preparedness is an evolving process, and we plan to continually update our procedures as appropriate.

A requirement to issue a report by a date certain may not give us the flexibility to incorporate the procedures and lessons learned from tests.

In addition, we currently submit an SPR annual report and four SPR quarterly reports under the existing EPCA requirements.

The SPR-related topics cited in section 7 would normally be addressed in these existing reports. Requirements for new and duplicative reporting procedures should be avoided in this legislation.

This concludes my statement, Mr. Chairman. I would be pleased to respond to any questions of yours or members of the committee.

[The material submitted by Mr. Vaughan follows:]

Department of Energy
Washington, D.C. 20585

October 19, 1983

Honorable James A. McClure
Chairman
Committee on Energy and Natural
Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This presents the views of the Administration on S. 1678, the "Energy Emergency Preparedness Act Amendments of 1983."

S.1678 would amend the energy emergency authorities in the Energy Policy and Conservation Act, Pub. L. No. 94-163, and the Energy Emergency Preparedness Act of 1982, Pub. L. No. 97-229, to (1) assure the availability and effectiveness of the energy emergency executive reserves and voluntary agreements in energy emergencies, (2) require an average fill rate of the Strategic Petroleum Reserve (SPR) of at least 145,000 barrels per day, (3) extend the antitrust defense for U.S. oil companies participating in the International Energy Program until June 30, 1985, (4) permit the Federal Government to preempt the operation of any state or local law dealing with the pricing or allocation of petroleum products, and (5) require reports to Congress on a number of emergency preparedness issues.

In general, the Administration supports and encourages legislative efforts to address the energy emergency preparedness issues which are the subject of this bill. As discussed by both Budget Director Stockman and Secretary Hodel in their letters of July 19, 1983, this Administration shares with you a strong commitment to ensure that the Nation's energy emergency preparedness response capability is adequate to safeguard the national security and to deal with energy supply disruptions.

The Administration is strongly committed to utilizing the assistance of the private sector, including the energy emergency executive reserves and as necessary, voluntary agreements, in domestic and international energy emergencies in order to meet both defense-related and non-defense-related needs. The Federal Government could never maintain, on a continuing basis, sufficient personnel with adequate expertise to be able to respond as needed to a wide range of potential energy emergency situations. Even if such persons were hired initially, very quickly they would lose their level of expertise by virtue of being out of the actual energy business.

On the other hand, in the private sector the United States has extensive expertise in a wide range of energy operational matters. The Administration wants to be sure that existing conflict of interest and antitrust laws do not serve as a substantial deterrent to private sector involvement in the Government's efforts to deal with energy emergencies, with the result that the Federal Government would be unable to avail itself fully of this pool of talent through effective use of the executive reserve organizations, voluntary agreements, and advisory committees. A reason is that industry, whether correctly or not, has a strong apprehension that good faith actions taken by participants in an effort to assist the Federal Government in dealing with actual or prospective energy emergencies may result in civil or criminal litigation, or even in liability. Whether this apprehension is justified or not, these laws should not preclude the United States from having the capability to respond as well as it might to future energy supply disruptions that may occur. Section 3(a) of S. 1678 is an important step in providing this relief by adding new sections 273 and 274 to the Energy Policy and Conservation Act (EPCA) which would provide broader and more flexible authority for the use of DOE's executive reserve organizations and of voluntary agreements and plans of action than is contained in existing law. Accordingly, the Administration supports the need for legislative action on these subjects.

At the same time, the Administration believes it is important to assure that legislation intended to ameliorate this problem does not create a situation which lends itself to abuse. Consequently, we believe that revision of the proposed sections 273 and 274 is necessary to narrow the relief proposed. For example, the waiver authority with respect to conflict of interest laws in proposed section 273 should be revised in such a manner as to tailor it to the impediments to industry's participation in executive reserve organizations, rather than granted on a blanket basis. With respect to the proposed section 273 authority to waive applicability of the antitrust laws in connection with executive reserve organizations, it would seem sufficient, for example, to overcome the justified apprehensions of industry if this waiver were limited to those actions of government employees or consultants which are taken in good faith within the scope of their authority.

Some limitation on the availability of section 274, providing an antitrust defense to participants in voluntary agreements or plans of action, also is called for. In the Administration's view, it should be made clear, among other things, that the benefit of the antitrust defense would be enjoyed only when and to the extent that participants were carrying out tasks at the request of the President.

The Administration would be pleased to work with the Committee in narrowing the language of the conflict of interest and antitrust provisions along these lines, or any others which would assure that the necessary corrective legislation is not written in a manner which results in abuse or unintended consequences.

The Administration strongly supports section 4 of the bill which would extend to June 30, 1985, the antitrust defense afforded by section 252(f) of EPCA to United States oil companies participating in implementing the Agreement on an International Energy Program.

Section 4(a) would amend section 252(j) of the EPCA by changing the expiration date of that section from December 31, 1983, to June 30, 1985, to synchronize its expiration with Titles I and II of EPCA. The extension would continue the antitrust defense afforded by section 252(f) of EPCA to U.S. oil companies participating in the Agreement on an International Energy Program (IEP), thus facilitating the continued participation of U.S. oil companies in the IEP. All of the conditions and safeguards presently incorporated in section 252 will remain.

There are presently 21 signatories to the IEP consisting of most of the principal industrialized oil consuming nations. The agreement provided for creation of the International Energy Agency (IEA) as an autonomous entity within the Organization for Economic Cooperation and Development, and established an international oil sharing system for use during oil supply emergencies, and an information system on the international oil market. It also required each country to establish emergency petroleum reserves, and to have a means for restraining demand for petroleum products in the event of an interruption of petroleum supplies to the IEP countries.

Section 252 of EPCA sets out procedures applicable to the development or carrying out of voluntary agreements and plans of action to implement the allocation and information provisions of the IEP. Pursuant to this authority, effective March 21, 1976, U.S. oil companies entered into the Voluntary Agreement and Plan of Action to Implement the International Energy Program (the Voluntary Agreement) (41 F.R. 13998, April 1, 1976). At present, 20 U.S. oil companies, including both major international oil companies and independent oil companies, are participants in the Voluntary Agreement.

The antitrust defense made available by section 252(f) is essential to the participation of U.S. oil companies in the Voluntary Agreement and, through it, in the IEP. The IEP, in turn, can function effectively only with participation by U.S. and foreign oil companies which are primary sources of information about conditions in the international oil market and would be the primary actors in redistributing oil if the IEP's emergency sharing provisions were activated.

Section 4(b) would effect four essentially technical changes to EPCA §252 to simplify the procedures applicable to the development and U.S. Government monitoring of voluntary agreements and plans of action. The Administration supports these amendments.

The Administration, however, is concerned about certain other provisions in the bill. Some changes should be made in the section 2 statement of findings and purposes in order to more accurately reflect the policy of primary reliance upon the free market that the bill is directed at supporting, and to better characterize the circumstances under which private sector organizations might be utilized. First, this section should make clear that not only State and local, but also Federal pricing and allocation of petroleum could frustrate free market policies; less emphasis should be placed on Federal Government intervention in markets. Accordingly, we believe that section 2(a)(2) of the bill should be revised to read:

> "(2) individual State and local as well as Federal, pricing and allocation of petroleum could frustrate free market pricing and allocation of available petroleum supplies."

The conforming amendment at section 6(b)(3) of the bill should be revised in like manner, and section 2(b)(1)(D) and the amendment at section 6(b)(4) should be amended by deleting the words, "State or local."

Second, we believe the Congress should make it clear its intention that private sector organizations would be activated to deal only with truly national or international, rather than purely local emergencies. This intention would be better indicated in the bill by referring, in section 2(b)(1)(B), to the use of such organizations in "energy emergencies of national or international character in order to meet defense-related or non-defense-related needs;". In order to carry this concept through in subsequent provisions of the bill, similar language should be used in the proposed new EPCA section 274(a), to describe the kind of emergency which would warrant the use of voluntary agreements and plans of action; where proposed sections 273(a)(4) and (c)(1) refer to a Presidential finding that "the national interest" requires exercise of the authority contained therein, "requires" should be stricken and "and achievement of the purpose described in section 2(b)(1)(B) of the Energy Emergency Preparedness Act Amendments of 1983" inserted immediately following "interest"; and proposed section 273(b) should be revised by inserting at its beginning, "To achieve the purpose of section 2(b)(1)(B) of the Energy Emergency Preparedness Act Amendments of 1983,". In addition, we recommend that the phrase, "Except when there is in effect a Presidential declaration that there exists an energy emergency of national or international character," be inserted at the beginning of subparagraphs (A) and (B) of proposed EPCA section 273(a)(2). Finally, we note omission of the word "in" before "the Energy Emergency Preparedness Act of 1982" in section 2(b)(2)(A) of the bill.

The Administration also is concerned about the approach this bill takes to the subject of preemption of State and local laws dealing with the pricing and allocation of petroleum products. Proposed new EPCA section 275 would preempt all such laws in advance of any emergency, irrespective of their purposes or effects, while leaving it to the President to carve out limited exceptions to the general prohibition. We think this reverses the presumption that ought to apply to State and local laws, and represents an unwarranted departure from principles of Federalism. We are cognizant, however, of the concerns that have been voiced that State and local laws could, at some point, aggravate an oil supply disruption before steps were taken to confine them to their proper constitutional scope. In light of these competing considerations, we believe a balanced approach would be to empower the President to preempt only those laws and regulations which require preemption, if during a declared energy emergency of national or international character he concludes that State or local laws are interfering in the domestic marketplace in such a manner as to worsen the emergency and that they unduly burden interstate commerce. We therefore recommend that the following be substituted for subsection (a) of the proposed section 275:

> "(a) PREEMPTION.--(1) When a declaration by the President is in effect that there exists an energy emergency of national or international character, he shall periodically assess whether the adoption of residual fuel oil or other petroleum product pricing or allocation laws by States or political subdivisions thereof interferes or is likely to interfere in the domestic marketplace in such a manner as to worsen the energy emergency nationally and unduly burden interstate commerce. If the President concludes that such interference is occurring or is likely to occur, he may specify, individually or by classes or categories, any or all laws or regulations adopted by States or political subdivisions thereof (except for set-aside programs approved pursuant to subsection (b)) which in his judgment require preemption, and those laws and regulations are hereby preempted from the time he so specifies,
>
> to the extent that they provide for the pricing or allocation of residual fuel oil or any other petroleum product. The President may from time to time, in his discretion, revise the list, classes or categories of preempted laws or regulations, and shall terminate the preemption of such laws or regulations when he finds that they no longer would worsen the energy emergency nationally and unduly burden interstate commerce.
>
> "(2) No action of the President under paragraph (1) shall be subject to judicial review."

Subsection (b), authorizing State set-aside programs, requires one change: subparagraph (b)(2)(E) would be redesignated as (F) and a new subparagraph (D) would be inserted, providing that the authorized State set-aside program "does not authorize the Governor to fix or limit the price of any residual fuel oil or other refined petroleum product which is set-aside."

Subsection (c) of section 275, which statutorily protects consumer inventories from State action, should be made applicable regardless of whether a State set-aside program is in effect or State laws are being preempted by the President. Accordingly, the words "Notwithstanding subsection (b)" should be deleted, leaving as the introduction to this subsection, "No State shall have authority to -". In addition, subsection 275(c)(2) should be revised to read as follows:

> "(2) For purposes of paragraph (1) -
>
> "(A) The term 'consumer petroleum inventory' means an inventory of residual fuel oil or other refined petroleum products which is owned by a consumer (other than a refiner, except to the extent provided in subparagraph (B)) for such consumer's own end-use consumption."

Subparagraph (C) would be redesignated as (B).

Another provision which gives us some concern is the proposed new EPCA section 161(h), authorizing the President to order priority performance or acceptance of contracts or orders in connection with drawdown and distribution of the Strategic Petroleum Reserve (SPR). This provision, which would grant powers comparable to those under section 101(a) of the Defense Production Act, is broader than can be justified and is not warranted.

The Administration also has a number of technical concerns about S. 1678. These are discussed below.

Executive Reserves; Voluntary Agreements and Plans of Action

Section 3 of the bill would add new sections 273 and 274 to the Energy Policy and Conservation Act. Our specific comments about these new sections are as follows:

Sections 273(a)(6) and (c)(2) of EPCA

These provisions require that an appointee to the executive reserves file a statement with the Secretary of Energy dealing with financial and employment interests. "Officer and director" should be changed to "officer, director, or employee" each time it appears to ensure that employment is included within the scope of financial interests.

Sections 273(a)(4)(B);(b)(2); and (c)(1)(B); 274(f)(1) of EPCA

These provisions would permit the President to waive the antitrust laws with respect to the members of the executive reserves. In order to ensure that there could be no potential conflict with State laws, and that there is consistency with section 252 of EPCA that provides an antitrust defense for firms participating in voluntary agreements or plans of action to meet U.S. obligations under the Agreement on an International Energy Program, "or any similar State law" should be inserted immediately after "section 3(9))" each time it appears.

The bill as drafted, however, would provide antitrust protection for executive reservists but not for their employers or former employers, who potentially could be subject to liability for the actions of their employees or former employees. This omission could defeat the purpose of the bill because employers would be very reluctant or unwilling to allow employees to participate in the executive reserves. We hope to work closely with the committee to develop a resolution to this problem.

Section 273(b) of EPCA

This provision should be amended to clarify that only the "voluntary" services of State or local agencies would be utilized.

Section 273(d) of EPCA

This provision would exempt the executive reservists from the operation of the advisory committee laws. To ensure that no Federal official could be considered to be in violation of these advisory committee laws by meeting or consulting with the executive reservists, subsection (d) should be amended to read as follows:

> "Notwithstanding any other law, any activities conducted under this section are exempt from the operation of all Federal laws, rules, and regulations pertaining to advisory committees."

Section 274(c) of EPCA

This subsection would establish the general guidelines for meetings to develop or carry out voluntary agreements or plans of action. The Administration opposes the proposed procedural requirements, including open meetings at which the public might present views orally, a verbatim transcript of all meetings, and a complete record of all communications. Adherence to these procedural requirements would make it impossible for the participants to engage in free and open discussions, many involving sensitive national security or trade issues, thereby limiting the potential utility of voluntary agreements and plans of action.

Section 274(c)(1)(C) of EPCA

This subsection would require a full-time Department of Energy employee to be present at any meeting to develop or carry out a voluntary agreement or plan of action. This provision is unnecessary and should be deleted because subsection 274(c)(1)(A)(iii) requires that all such meetings must be chaired by a full-time employee of the Department of Energy.

Section 274(d)(1) of EPCA

This subsection would establish the procedure for approval of voluntary agreements and plans of action. It is critical during an emergency to ensure that an approval by the Secretary of Energy and the Attorney General regarding these voluntary agreements and plans of action can be relied upon by the participants. We recommend that the approval by the Secretary of Energy and the Attorney General not be subject to judicial review and that the following be inserted immediately after the last sentence in this subsection: "No approval of a voluntary agreement or plan of action under this subsection shall be subject to judicial review." For consistency, a similar provision should be added to EPCA section 252(d).

Section 274(f) of ECPA

This subsection would make available an antitrust defense for actions taken to develop or carry out voluntary agreements or plans of action, subject to the proviso that "such actions were not taken for the purpose of injuring competition." This is the same language used in EPCA section 252(f)(1). Proposed section 274(f)(2), like existing section 252(f)(2), provides that under certain circumstances, the person asserting the defense must prove that his actions were within the contemplation of an approved plan of action. However, section 274(f) does not include the provision which is contained at section 252(f)(3):

> (3) Persons interposing the defense provided by this subsection shall have the burden of proof, except that the burden shall be on the person against whom the defense is asserted with respect to whether the actions were taken for the purpose of injuring competition.

This is an important aspect of the antitrust defense; therefore, this same provision should be added to section 274 as subsection (f)(3).

Strategic Petroleum Reserve

Section 5(b) (Adding new subsection 161(g) of EPCA)

This subsection would make clear that nothing in sections 161 or 159 of EPCA should be viewed as limiting the Secretary's authority to conduct test sales of petroleum products from the Strategic Petroleum Reserve.

We note the need for an amendment to proposed subsection (g) to provide for the augmentation of the off-budget account by the amount of any proceeds from test sales. Absent express statutory authority to retain them, it would appear that receipts from a test sale of SPR oil would have to be paid over to the Treasury's miscellaneous receipts account, see 31 U.S.C. § 3302(b) and Department of Interior and Related Agencies Appropriation Act, Fiscal Year 1983, Pub. L. No. 97-394, 96 Stat. 1966, 1987 (1982), whereas any proceeds from oil sales during a drawdown and distribution in a severe energy supply emergency or to meet U.S. obligations under the Agreement on an International Energy Program are deposited in the off-budget account, pursuant to section 167(b)(3) of EPCA. Therefore, actual sales of SPR oil during a drawdown and distribution test likely would have an adverse effect on the SPR's fill rate. The limitation in section 167 could be remedied by rewriting proposed subsection (g) to add the following sentence:

> "The receipts from such sales shall be deposited in the "SPR Petroleum Account" under section 167 and shall be subject to section 167(d)."

Reporting Requirements

Section 7 of the bill would establish several new reporting requirements. The Administration opposes the requirement for these additional reports because they are costly and duplicative of existing reporting requirements. The Department of Energy already prepares an annual report and four quarterly reports under the EPCA provisions as amended. The SPR-related reporting requirements set forth in this section could be addressed in these other existing reports, rather than requiring new reports. We believe that paragraph (a)(3) of section 7 should be deleted for the further reason that it implies an ongoing responsibility of the Secretary of Energy to take actions to protect against State and local adoption of price and allocation laws.

The Office of Management and Budget advises that from the standpoint of the President's program, there is no objection to the submission of this report for the consideration of the Committee.

Sincerely,

William A. Vaughan

William A. Vaughan
Assistant Secretary
Environmental Protection, Safety,
and Emergency Preparedness

Department of Energy
Washington, D.C. 20585

September 19, 1983

The attached report was prepared and transmitted to the International Energy Agency by the Office of the Assistant Secretary for Environmental Protection, Safety and Emergency Preparedness of the Department of Energy.

Attachment

August 24, 1983

Appraisal Report of the Fourth Allocation Systems Test (AST-4) of the International Energy Agency by the United States National Emergency Sharing Organization

I. INTRODUCTION

The fourth test of the International Energy Agency (IEA) Emergency Sharing System (AST-4) was most beneficial for the U.S. National Emergency Sharing Organization (NESO). It provided an opportunity for participants to have "hands-on" experience in carrying out NESO responsibilities in connection with the IEA Emergency Sharing System. It also promoted a greater awareness within the U.S. NESO, other Federal agencies, States, and the private sector of the effects of an energy emergency. Finally, AST-4 revealed issues and problems associated with both the IEA system and severe energy emergencies in general, which would have most likely remained less evident were it not for the regimen of the test.

II. U.S. NESO PERFORMANCE IN AST-4

1. Overview of U.S. Participation in AST-4

The objectives of U.S. participation in AST-4 were:

- To train U.S. NESO personnel in the data handling, analytic, and administrative procedures necessary to carry out U.S. responsibilities in connection with the operation of the IEA emergency oil sharing system.
- To otherwise involve, to the fullest extent practicable, all elements of the NESO essential to the efficient and successful operation of the IEA system, including national emergency procedures.
- To test modifications and improvements made to the IEA system since the last test in the autumn of 1980.

- To exercise, within practicable limits, decisionmaking, communication, and other Federal and State government procedures in connection with a broad range of public and private activities which may be initiated in response to an energy supply disruption, both internationally and within the United States.

In our opinion, all of these objectives were fulfilled, and, on that basis, AST-4 was a successful endeavor. U.S. participation in AST-4 was considerably more extensive than in previous exercises. Within the Department of Energy, which functions as the U.S. NESO, about 60 persons were directly involved on a continuing basis. An additional 20 or so individuals provided Department-wide coordination through the Emergency Response Working Group (ERWG) which met periodically during the test.

One aspect of U.S. exercise play was to simulate Federal energy emergency response. Offices which were heavily involved in AST-4 included the White House, the Departments of State, Defense, Transportation, and Agriculture, and the Federal Emergency Management Agency. This participation provided an unprecedented opportunity for involvement in NESO decisionmaking by those agencies which would be significant actors in an actual international oil supply disruption. Congressional Staff participated, and the U.S. General Accounting Office monitored test play on the "Dialcom" electronic mail system.

For the first time all States and the National Governors Association were involved in such an exercise. Ten states were active players while the others were able to monitor test activities since they were tied into the "Dialcom" electronic mail system, which the NESO used to communicate with domestic players. Also the level of activity among the States and the U.S. NESO was significantly greater than in AST-3 and resulted in a 300 percent increase in message traffic as compared to the previous exercise.

The most dramatic increase, as compared to prior exercises, was in the involvement of private sector groups, many for the first time. This included players and observers from environmental groups, oil industry associations, persons associated with the U.S. National Defense Executive Reserve (NDER)*/, and, most significantly, Non-Reporting Companies (NRCs) (i.e., oil producers, refiners and industrial energy consumers which have not been requested by the U.S. Government to become Reporting Companies and, thus, are not participants in the U.S. Voluntary Agreement and Plan of Action). About 80 NRCs were asked to participate as players by submitting voluntary offers through the NESO to the international allocation system. Of these, 27 submitted supply (sell) offers.

This broad-based participation contributed substantially to the benefits derived from the test:

- It provided the NESO a better sense of the coordination required among its own offices and between itself and other Federal agencies, States and the private sector to address the breadth of issues arising from a severe energy supply disruption.
- It provided the NESO a better perspective on the behavior of the States and the private sector in dealing with an energy emergency in a decentralized environment.
- It was instrumental in identifying problems in connection with both the IEA system and AST-4 test design, as well as the preparedness of the U.S. NESO.

2. The U.S. Market-Oriented Approach

U.S. participation in the exercise was in consonance with the Administration's policy of placing maximum reliance on market forces in responding to severe energy emergencies. In both test cycles, analyses of the scenario impacts on the U.S., including estimates of the reduction in U.S. petroleum consumption, assumed a free market response to the postulated disruption. These analyses provided the basis for U.S. demand restraint guidance to U.S. companies, and the expanded economic impacts report which the Federal government and States used in considering emergency response options.

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*/The National Defense Executive Reserve (NDER) was established by statute and an Executive Order and is composed of civilians selected for training for employment in executive positions in the Federal Government in the event of national emergencies. In particular, DOE has three NDER units: (1) Emergency Electric Power Executive Reserve, (2) Emergency Petroleum and Gas Executive Reserve and (3) Emergency Solid Fuels Executive Reserve.

An integral part of such analyses was the calculation of the estimated rise in world crude and domestic product prices. In AST-4 these estimates were calculated under the constraints inherent in the scenario and test design, as interpreted by the computer models used. Accordingly, the escalation in the price of crude starting in April assumed no U.S. Government action from the end of December, when some elements of the disruption began, until the start of the exercise on May 2. The price rise in April, calculated by Department of Energy models, was predicated on two factors in the scenario: the size of the disruption and the reduction in inventories during January-March to near minimum operating levels on April 1.

Crude and product price information was included in the Cycle 1 demand restraint guidance in order to allow U.S. domestic participants, the States and other private sector participants to respond to the supply disruption in the context of the free market programs being implemented. Since State-by-State disrupted supply data were not available for various petroleum products, the only way to provide domestic test participants with a measure of the impacts of the disruption was to provide simulated price and sectorial economic impact information generated by econometric models. Using such information, the various States and some of the other domestic participants (particularly industrial players) were able to estimate expected demand results, as well as the economic impacts of the disruption on their particular situations. This had a substantial effect upon the response measures which the various States chose to implement, as well as the kinds of responses at the Federal level that were requested. The price data were intended solely for domestic AST-4 play..

3. Exercise Management

The exercise was managed on a day-to-day basis by the Deputy Assistant Secretary for Energy Emergencies, who also serves as the Deputy NESO Operating Head. Coordination of exercise activities was facilitated through daily meetings of the lead staff personnel involved in the test, which included persons from the DOE Offices of Environmental Protection, Safety and Emergency Preparedness; International Affairs; and the Energy Information Administration, as well as other Department of Energy Offices. These meetings were also open to representatives of other Federal agencies.

At a staff level, the Emergency Response Working Group (ERWG) met four times to consider major issues before submitting recommendations to the Secretary of Energy, who serves as the Political Head of the U.S. NESO. The ERWG is the group within the Department of Energy responsible for coordinating staff level actions on energy emergency issues. The ERWG meetings were also attended by observers from other Federal agencies, including the Departments of Defense and State, the Federal Trade Commission, and the Federal Emergency Management Agency.

4. Communications

The NESO had extensive interaction with the ten States which actively participated in the domestic part of the exercise.

The electronic mail system which was used to communicate with States proved adequate for the exercise, although remedial action was required to avoid system overload. This same system was used to communicate with other domestic actors outside of the NESO, including Non-Reporting Companies, other private sector players and observers, and observers in the U.S. Congress and non-participating States.

Communications with the IEA and ISAG proceeded very smoothly, and their country coordinator systems worked well.

There is a need to review closely the operation of the IEA with regard to NESO-IEA interaction and communication in connection with the following topics: 1) the need for NESOs to keep informed of ISAG operations, and 2) the desire to have more informative reports with regard to accounting for Allocation Rights/Obligations. Each of these topics is addressed in the section of this report entitled "IEA Secretariat/ISAG Operations."

Communication among the U.S. NESO and other NESOs was limited in the exercise and, for the most part, was in connection with resolving data discrepancies between the U.S. and the United Kingdom. The U.S. NESO did have some contact with the Canadian NESO with respect to natural gas availability, as well as some coordination on exchanges of petroleum products. These interactions were conducted expeditiously and effectively during the test.

5. Response of U.S. Companies

U.S. companies exhibited a high degree of cooperation in the exercise. Reporting Companies submitted Questionaire A's (QuA's) in a timely fashion and were forthcoming in making voluntary supply offers to meet the U.S. Allocation Obligation in the first cycle. Of the 19 U.S. Reporting Companies participating in the test, 14 made voluntary offers for a total (based on IEA data) of 4.25 million metric tons (MT), or 2.28 Million MT excluding swaps.

The U.S. NESO was very pleased with the response of the Non-Reporting Companies. Invitations to participate were extended to major Non-Reporting Company importers for the period March-August 1981. This group was augmented by a selection of firms in heavy energy use industries such as motor vehicle production, metal refining, petrochemicals, and pulp and paper production. The resulting universe consisted of almost 80 companies and included both oil companies and companies in other industries which are importers or users of petroleum. Of these, 27 responded with voluntary offers totalling (based upon U.S. NESO calculations) 5.225 million MT. This was the first IEA exercise in which U.S. NRCs participated to any significant degree. The exercise uncovered a number of issues concerning the NRC interaction with the IEA, particularly with respect to the voluntary offer system.

Total voluntary supply offers were more than sufficient to meet the U.S. Allocation Obligation in the first cycle. The cumulative AO for the period May-July was approximately 23 million barrels (3.1 million MT) while voluntary offers for that period amounted to about 9.3 million MT gross; 7.2 million MT net.*/ Because of this overwhelming response, the U.S. NESO did not find it necessary to simulate any fair-sharing scheme.

The U.S. NESO recognizes the concerns expressed by some of the Reporting Companies about the absence of implementation of a "fair-sharing" program during AST-4. Additionally, the U.S. NESO recognizes the obligation of the United States to support compliance with the

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*/The U.S. NESO calculated slightly different numbers. This discrepancy should be reviewed as part of the post-AST-4 analysis by IEA.

International Energy Program's Emergency Sharing System. However, based upon the results of the submission of voluntary offers during AST-4, there was simply no need to adopt any programmatic measures in order to meet the U.S. allocation obligation.

In the event that sufficient voluntary offers had not been submitted, the following two "fair-sharing" type options would have been available:

1. Drawdown of the SPR, allowing companies submitting voluntary offers to replace those supplies by bidding on SPR oil (with the additional option of directing up to 10% of the volumes drawn down to specific companies); and

2. Implementing a system of direct supply orders to various companies on a fair and equitable basis, to ensure that the burden of participating in the IEP is not borne disproportionately by any one company or group of companies.

Thus, the U.S. NESO was fully prepared to implement such measures as may have been required to meet the commitments of the United States to the IEA.

Solicitation of voluntary offers was by letter and telephone; both RCs and NRCs were contacted. In the case of NRCs, offers were transmitted by telephone or electronic mail, and, in some cases, followed up by a letter or telex. The NESO reviewed these offers for reasonableness and, in a number of instances, contacted the company for reconfirmation. For certain very large offers, the Deputy NESO Operating Head dealt with the company personally. No voluntary offer was accepted unless, based upon the data available, the U.S. NESO determined the offer to be credible.

The exercise revealed that U.S. NESO operations in this area need improvement. In particular: 1) Reporting Companies will be requested to advise the U.S. NESO of all offers (or withdrawals of offers) made to the ISAG; and 2) the procedures for eliciting and accounting for NRC offers need to be more fully developed to ensure that the offers are technically correct.

6. Data Issues

The U.S. NESO had no logistical problems in processing QuAs and generating Questionaire B's (QuBs) for submission to the IEA. However, because of the internal U.S. clearance process for submission of the approval of the QuBs, the U.S. NESO was not as timely with these filings as it would have liked. This is something that we will review to see if improvements can be made. In addition, a number of policy issues arose in connection with the development of the data for the QuBs, which also affected the ability of the U.S. NESO to submit the QuBs on time. Some of these data issues apply only to the test setting, while others might occur in the context of an actual emergency. Such issues, which will be discussed in a later section of this report, pointed up areas for consideration by the IEA after AST-4, and, as such, were valuable outcomes of the test experience.

The U.S. NESO made some mistakes in preparing NRC offers from information provided by the companies. Mistakes included indicating inappropriately sized vessels, offering more oil from a country of origin than was shown available in QuBs for the time period of the offer, and not correctly completing the input telex format. The primary cause of these problems was that some NRCs could not readily provide parcel-by-parcel information on their offers, thus requiring the U.S. NESO to simulate some information provided to the IEA. In an actual emergency, detailed information would have been available and mistakes of these types would not have occurred. In addition, due to inexperience and confusion with respect to the test rules, incorrect voluntary offers were submitted by the U.S. NESO as to foreign stocks (in Belgium) and floating stocks (Caribbean). These were corrected expeditiously when the errors were called to our attention. Here again, the test served as a valuable learning experience for U.S. NESO personnel with respect to IEA data submission requirements. The U.S. NESO is grateful for the help provided by the ISAG in correcting the most glaring errors, and resubmitting offers.

III. IEA SECRETARIAT/ISAG OPERATIONS

1. General

In general, the U.S. NESO wants to compliment the IEA, the SEQ, the ISAG, and others involved in the international aspects of AST-4 for their work preparing for and conducting the test. The U.S. NESO found AST-4 to be an extremely valuable learning experience, for which the IEA and its committees and professional staff deserve considerable credit. While some problems did occur during the test which merit further study, this is to be expected--and is desirable--in a simulation such as this.

AST-4 revealed several problems with regard to: 1) the operation of the IEA Emergency Sharing System; and 2) the design and rules of the exercise itself.

2. Availability of Information to NESOs

A key aspect of the workability of the IEA sharing system is the availability to the various member countries of information about what is happening in other nations as to their participation in the IEA system. To some extent this problem may be less pronounced in a real crisis, when IEA member countries would be interacting more intensively. However, the U.S. NESO suggests that the IEA review this issue to determine whether there is a problem, and whether additional information might be supplied to NESOs during subsequent tests.

For example, it would be very useful to know monthly during the test how other NESOs were dealing with demand restraint measures, and with allocation obligations. Also, information on how other NESOs were handling data issues, and domestic participation, would have been quite interesting. As part of the post-AST-4 review, the IEA should consider the possibility of supplying more information to NESOs on ISAG and on other IEA activities during ASTs (as well as during actual emergencies).

NESOs would benefit from reports from the IEA showing all offers submitted to the IEA by companies within the NESO's jurisdiction. This would enable NESOs to reconcile their own records with those of the ISAG and to take action to resolve any differences which may be uncovered.

3. Handling of Offers from Inventory

An important aspect of U.S. NESO participation in AST-4 involved the offering of volumes of petroleum from domestic inventories, including petroleum products as well as crude oil. Crude oil was also tendered from domestic U.S. production. These voluntary offers raised interesting questions as to logistics, information availability with respect to the supplies, and how such offers should be tendered under applicable reporting formats.

Given the unusual nature of these supplies, compared to the customary offers of cargoes at sea, the IEA system seemed to adapt well. In AST-4, the ISAG arranged for exchanges (swaps) between U.S. companies in order to substitute offers from landed inventories for cargoes at sea. To do this the ISAG obtained offers to sell oil in transit from certain U.S. companies in exchange for off-setting purchases of oil originally offered by other U.S. companies out of their landed stocks.

The treatment of inventories for purposes of voluntary offers should be evaluated. Since this oil is not shown in the current QuB as imports, the IEA should review the procedures appropriate for accounting for VOs from inventories.

4. Reporting of ARs/AOs and Accounting for Offers

The reporting of allocation rights/obligations, including the application of supply offers against allocation obligations needs to be reviewed. The purpose of the reports provided by the Secretariat during AST-4 apparently was to provide the information necessary for NESOs to gauge their success in eliciting or mandating offers, and to take further action if necessary.

The U.S. NESO experienced some difficulty interpreting the reports provided to it by the IEA. It is not clear whether this was a problem with our understanding of the documents, or whether some revisions as to format and content might be appropriate. We would be interested in learning what the reactions of other NESOs were to these reports. Another problem which surfaced during the test was that the U.S. Reporting Companies did not always supply the U.S. NESO with copies of cables or telexes sent to Paris with respect to the voluntary offer process, at least initially. This problem can be corrected by better coordination with Reporting Companies, and we will work with U.S. companies to accomplish this.

5. Principles and Procedures Governing Non-Reporting Company Participation

A principal goal of the U.S. NESO in AST-4 was to broaden participation in the IEA system by various U.S. interests, including other Federal agencies, State agencies and private companies and individuals. This effort was a major success, and should significantly enhance the understanding of IEA matters within the U.S., and the ability of the U.S. to support the various IEA programs.

In the course of the voluntary offer process, however, a number of issues arose with respect to the participation of Non-Reporting Companies (NRCs) which need to be reviewed. Information about the IEA and about AST-4 was not disseminated soon enough, which reduced the ability of companies not generally familiar with the IEA system to become as familiar as would have been desirable, in order to participate in the test most effectively. Solving this problem will require a review at the IEA level of what information should be made available to NRCs, and in what formats. In addition, the U.S. NESO will strive in future tests to involve NRCs in the process at an earlier point in time.

A number of other questions arose with respect to NRC participation in AST-4, particularly in the voluntary offer process. By and large, the NRCs did not have available to them the same kinds of detailed information which Reporting Companies had as to their historical oil supplies. This created some difficulty for the U.S. NESO in making the voluntary offer submissions in the format required. We consider the experience of AST-4 extremely valuable in learning about the potential role for NRCs in the Emergency Sharing System, and would urge the IEA to review the role of NRCs in the IEA system generally.

At the present time NRC interaction with the IEA is limited to making offers through NESOs once the international allocation system is triggered. Otherwise there is no arrangement for NRCs to provide input to the IEA on international matters about which they may have concerns. In the U.S., NRCs are important as they account for about 33% of total petroleum supply and about 25% of imports of crude and products. To the extent that NRCs are more involved in IEA matters, the overall effectiveness of the system is that much better. Toward that end, the U.S. NESO will seek to identify ways to involve NRCs in support of U.S. participation in the IEA Emergency Sharing System.

6. Principles Governing The Use of Supply (QuB) Data In Systems Test

An issue arose in AST-4, in connection with QuB data development, that could severely reduce the flexibility of NESO and company behavior in future exercises, and possibly in an actual emergency. The issue has to do with the ability of QuB data to reflect the redistribution of oil internationally by Non-Reporting Companies. While the U.S. NESO recognizes that, in an emergency, this kind of data problem would probably not occur, in order to make the test more reflective of an actual emergency, the SEQ should address the issue for the benefit of future ASTs.

To the extent that future tests are designed with the assumption that NRCs will not redistribute oil internationally, the QuBs may not reflect the impact of market forces during the simulated disruption. Since the U.S. policy is to rely principally upon the free market to respond to severe energy supply disruptions, the U.S. NESO would be at a severe disadvantage participating in a test which, in effect, restricted the simulated operation of the market. And the results of such a test, insofar as the U.S. is concerned, would not be as useful or representative of what might actually occur substantively or procedurally.

Consideration of this issue, and clarifications where appropriate before the next AST of such other questions as the treatment of government-owned stocks in the data systems, and methodology for calculating the QuBs, should be an important part of the AST-4 follow-up activities at the IEA.

7. Selection of Base Data Used in the Exercise

The selection of March-August, 1981 QuA/QuB data for the exercise gave rise to certain problems in connection with participation of NRCs and other U.S. domestic players (other than RCs; for example, states, etc.).

- NRCs generally were not able to provide certain logistical details for their offers. Some do not keep detailed records of 2 year old energy use; others said that accessing such records would be exceedingly time consuming and expensive.

- Domestic players (other than PCs) found it difficult to predicate their actions on preliminary historical data when they are now aware of actual experience.
- Going back in time two years presents problems of distinguishing current policy and program realities from the exercise. This causes confusion not only among players but also among outside observers who do not necessarily keep this distinction in mind.

In planning for subsequent exercises there is a need to consider the benefits and problems in using either a more recent historic or a real-time data base. The U.S. NESO recognizes that there are domestic antitrust issues which relate to this question, and that the advantages and disadvantages will have to be carefully weighed in plans for future ASTs.

8. Data Discrepancies

The problem of data discrepancies continued in AST-4. While the U.S. NESO recognizes that some of its actions to inject realism into exercise play may have exacerbated data differences among countries, it was pleased that the Allocation Coordinator followed the spirit of the established procedures by accepting the U.S. NESO's QuB as the best indication of the U.S. supply picture.

Since one of the main objectives of AST-4 was to test the data system, it was inevitable and useful that various questions arose during the test about data discrepancies. Rather than suggesting a failure, the pointing out of these problems affirms the fundamental success of AST-4 as a training, learning and system-testing experience. The U.S. NESO believes that it would be useful to review carefully the various issues which arose during AST-4, in order to implement such changes in the data system as might be needed. In some cases, the remedy might be as simple as more thorough understanding of the test rules and expectations by U.S. NESO personnel.

It is important to identify which issues are important solely in the context of a test, and which issues would apply during an actual emergency. For example, some of the trade discrepancies among countries might not exist were actual data available, rather than simulated during a test. In addition, the origin and subsequent destination of volumes of crude oil which were simulated to be diverted from the U.S. Strategic Petroleum Reserve would presumably be known in a real emergency, while, for purposes of this test, simulations and estimates had to be made.

It may well be that, during an AST, some trade discrepancies are inevitable. Nevertheless, this question bears further review. In addition, treatment of stocks at sea, No Present Destination (NPD) volumes, and other similar data questions should be reviewed, with a view to ensuring the minimum level of trade discrepancies.

9. Exercise Initiation

The U.S. NESO is pleased with the decision that allowed early distribution of the disruption scenario. This allowed more time for NESOs and companies to understand the scenario and its implications, and this time was also useful for the U.S. NESO to construct and distribute its demand restraint guidance.

10. Training To Operate The IEA System

The U.S. NESO believes that this exercise objective was successfully met in AST-4. Ongoing training in the operation of the IEA system should be continued, however, to iron out operational problems in a less formal environment than AST-4. The IEA system is sufficiently complex to require, consistent with budget limitations, intermediate training sessions which trace slowly through a system cycle, identifying the major analyses, decisions, and procedures. AST-4 could be used effectively in a case study fashion.

Training sessions should include both NESO and industry personnel, in contrast to the current practice of training these groups separately. The IEA system depends upon the smooth interaction of NESOs and industry personnel; problems experienced by one group may not be evident to the other. In addition, cross-fertilization of ideas through training sessions involving both groups would enhance the utility of training. The pre-briefings for full systems tests should include both groups to ensure that all parties have a common understanding of the upcoming exercise.

During AST-4 the U.S. NESO sought to involve as large a number of relevant government personnel as possible, in order to broaden the understanding of IEA matters and enhance overall preparedness. The U.S. NESO will be reviewing its training programs in light of some of the difficulties which were experienced during AST-4. The IEA may wish to consider holding briefings in member countries in years other than during an AST, in order to maintain a high level of understanding of the procedures and logistic requirements of the various IEA programs.

APPRAISAL OF THE FIRST CYCLE
OF THE
INTERNATIONAL ENERGY AGENCY
FOURTH ALLOCATION SYSTEMS TEST (AST-4)
BY THE
U.S. NATIONAL EMERGENCY SHARING ORGANIZATION

MAY 26, 1983

TELEX MESSAGE

THIS IS THE FIRST OF TWO ASSESSMENTS OF AST-4 BY THE U.S. NESO. EMPHASIS WILL BE PLACED ON ASSESSING TWO AREAS: INTERACTION BETWEEN THE IEA AND THE U.S. NESO, AND THE ORGANIZATIONAL PERFORMANCE OF THE U.S. NESO. THE OBSERVATIONS AND COMMENTS IN THIS REPORT ARE OF A PRELIMINARY NATURE AND ARE LIMITED TO EXERCISE EVENTS EXPERIENCED DURING THE PERIOD APRIL 22, 1983, THROUGH MAY 25, 1983. AS PROVIDED IN THE TEST GUIDE, THIS PRELIMINARY REPORT WILL BE FOLLOWED BY A COMPREHENSIVE ASSESSMENT REPORT AFTER THE CONCLUSION OF CYCLE II. AMONG OTHERS, THE U.S. NESO EXPECTS TO CONSIDER IN THE FINAL REPORT SUCH TOPICS AS U.S. POLICIES ON DEMAND RESTRAINT AND TRADE DISCREPANCIES.

IN GENERAL, WE FIND THAT THE OBJECTIVES OF AST-4 AS STATED IN THE TEST GUIDE ARE BEING REALIZED. IN ADDITION, THE EXERCISE IS PROVIDING AN OPPORTUNITY TO IDENTIFY ISSUES FOR FURTHER CONSIDERATION IN THE AREAS OF SUPPLY ENTITLEMENT DETERMINATION, DATA ACQUISITION AND PROCESSING, PROCEDURES IN CONNECTION WITH HANDLING VOLUNTARY OFFERS BY BOTH THE NESO AND THE IEA/ISAG, INTERGOVERNMENTAL AND INTERNATIONAL COMMUNICATIONS, AND TEST DESIGN INCLUDING SCENARIO DEVELOPMENT. THE FOLLOWING ARE OUR COMMENTS ON SPECIFIC TOPICS.

1. THE DISRUPTION TELEX WAS RECEIVED ON TIME AND OUTLINED THE ESSENCE OF THE DISRUPTION REASONABLY CLEARLY. HOWEVER, THE TELEX COULD HAVE BEEN MORE COMPLETE IN DEALING WITH ANCILLARY CONDITIONS SUCH AS THE AVAILABILITY OF SURGE PRODUCTION AND THE BEHAVIOR OF IEA MEMBERS WITH REGARD TO THEIR GOVERNMENT OWNED OR CONTROLLED STOCKS.

2. QUESTIONS CONCERNING GOVERNMENT CONTROLLED STOCKS, IN FACT, SEEM TO HAVE BEEN GENERALLY OVERLOOKED BY GOVERNMENTS AND THE IEA SECRETARIAT IN THE PREPARATION OF THE AST-4 TEST GUIDE. THE U.S. ASSUMPTION THAT ANTICIPATED DELIVERIES OF OIL TO THE U.S. SPR HAD BEEN CURTAILED DUE TO DECLARATION OF FORCE MAJEURE BY A LARGE NUMBER OF SUPPLIERS IS REASONABLE AND POSSIBLY COULD APPLY TO A NUMBER OF IEA COUNTRIES. SINCE THE TIMING OF THE QUB REVISIONS (TO REFLECT THE EFFECTS OF FORCE MAJEURE DECLARATIONS) MAY HAVE CAUSED TECHNICAL DIFFICULTIES FOR OTHER TEST PARTICIPANTS, THE U.S. NESO IS ADDRESSING THESE DIFFICULTIES IN THE QUB IN ADVANCE OF THE SECOND CYCLE. THE TEST GUIDE DOES NOT ADDRESS SUCH CONDITIONS EXPLICITLY AND THEREFORE PROVIDES NO CLEAR GUIDANCE ON HOW THESE SUPPLY CUTOFFS SHOULD BE HANDLED WITHIN THE IEA EMERGENCY DATA SYSTEM.

3. THE TEST GUIDE DOES NOT CLEARLY EXPLAIN HOW VOLUNTARY OFFERS ARE APPLIED AGAINST ALLOCATION OBLIGATIONS AND ALLOCATION RIGHTS FOR DIFFERENT MONTHS, AND THERE SEEMS TO BE NO REGULAR PROCESS FOR REPORTING IEA/ISAG PROGRESS IN THE RECEIPT AND MATCHING OF VOLUNTARY OFFERS. AS A RESULT, THE STATUS OF COUNTRIES WITH RESPECT TO THE SATISFACTION OF THEIR ALLOCATION OBLIGATIONS OR ALLOCATION RIGHTS REMAINS UNKNOWN DURING THE MONTH AND REMAINS UNCLEAR EVEN AT THE END OF THE MONTH.

4. THERE WOULD SEEM TO BE A QUESTION ON THE TREATMENT OF PARTIAL SHIPMENTS AND OFFERS OUT OF LANDED INVENTORIES BY THE ISAG AND THE NESO IN THE ALLOCATION PROCESS. MANY OFFERS MADE BY NRCS INVOLVE THESE SOURCES. THIS IS A SUBJECT MERITING STUDY AND DISCUSSION.

ALL MAJOR FUNCTIONS AND ELEMENTS OF THE U.S. NESO WERE THOROUGHLY EXERCISED DURING THE FIRST CYCLE OF PLAY. DURING THIS PERIOD OF TIME THE U.S. NESO:

1. CONDUCTED A DETAILED ANALYSIS OF THE SUPPLY EMERGENCY TO DETERMINE IMPACTS ON PETROLEUM PRICES, DEMANDS FOR PETROLEUM PRODUCTS, AND ECONOMIC INDICATORS.

2. ESTABLISHED AND MAINTAINED COORDINATION AND INVOLVEMENT WITH OTHER U.S. AGENCIES, STATE AND LOCAL GOVERNMENTS, AND A WIDE RANGE OF PRIVATE SECTOR PLAYERS. OBTAINED VOLUNTARY OFFERS FROM REPORTING AND NON-REPORTING COMPANIES.

3. PERFORMED POLICY ANALYSIS-ALL RELEVANT OFFICES WITHIN THE DEPARTMENT OF ENERGY PARTICIPATED TO PROVIDE AN AUTHORITATIVE BASIS FOR INTERPRETATION OF SCENARIO EVENTS AND POLICY DELIBERATIONS. THE ESTABLISHED EMERGENCY MANAGEMENT STRUCTURES AND PROCEDURES WITHIN THE DEPARTMENT WERE THOROUGHLY EXERCISED.

4. MET THE U.S. ALLOCATION OBLIGATION.

5. PROVIDED TIMELY DECISIONS. AT NO POINT WERE CRITICAL ACTIONS DELAYED DUE TO LACK OF GUIDANCE FROM SENIOR OFFICIALS. THE ABILITY TO ANTICIPATE REQUIRED DOE ACTIONS IN THE STREAM OF EXERCISE EVENTS WAS PRESENT AT CRITICAL POINTS.

6. ESTABLISHED AND MAINTAINED EFFECTIVE COMMUNICATIONS AMONG ALL PARTICIPATING ENTITIES, I.E., BETWEEN THE NESO AND IEA, THE NESO AND STATES, THE NESO AND REPORTING COMPANIES, AND WITHIN THE NESO STRUCTURE ITSELF.

The CHAIRMAN. Thank you very much, Mr. Secretary.

There is another vote on the floor of the Senate. Might I ask you, Secretary Wendt, if you could be prepared upon our return to summarize your statement in the view of the limitations of time. We have had so many interruptions. Perhaps if you could summarize it very briefly, we can then immediately proceed to questions tc both of you about administration policy.

Senator METZENBAUM. Mr. Chairman, I wonder——

Mr. Chairman, realistically speaking, it is 10 to 12, and until we get over and back, it is at least a 10-minute trip. I wonder if we couldn't when we come back inquire of Mr. Vaughan right after his statement, and then have the other gentleman——

The CHAIRMAN. Secretary Wendt, I think it would be important for us to get the views from the two different agencies of the Federal Government, which together represent the administration policy, and then proceed with the questioning of you both.

Under this procedure, if Mr. Wendt can briefly summarize his statement, we can proceed to those questions very quickly.

Senator METZENBAUM. But what I am really saying, Mr. Chairman, is that realistically speaking, that means that this hearing in order to get into the questions is going to go into 1 or 1:30.

The CHAIRMAN. Well, we'll get into questions, very quickly, I assure you when we get back.

Senator METZENBAUM. Well, let's try, but I do want to have the opportunity, because I have a number of questions for both of these gentlemen.

The CHAIRMAN. Yes, I understand that. I want to make sure that you do have that opportunity.

Thank you.

We will stand in recess subject to the call of the Chair.

[Whereupon, at 11:50 a.m., the hearing was recessed, subject to the call of the Chair.]

The CHAIRMAN. Mr. Secretary, your entire prepared statement will be placed in the record in full. I would invite you to summarize it at this time, if you will, please.

STATEMENT OF E. ALLAN WENDT, DEPUTY ASSISTANT SECRETARY OF STATE FOR INTERNATIONAL ENERGY POLICY, DEPARTMENT OF STATE

Mr. WENDT. Thank you very much, Mr. Chairman. I will as you suggested give the highlights of my testimony.

I think this hearing is timely because as events in the Middle East remind us again there is always the possibility of a supply disruption, and while no one can predict what events may transpire as a result of the Iran/Iraq war, we certainly can't rule out the possibility that the conflict could affect our energy supplies.

I think, Mr. Chairman, that the United States is well prepared for an energy emergency. As Mr. Vaughan said, we have a strategic petroleum reserve now of over 365 million barrels. We also have, through the IEA, a system of providing for participation with our allies in an international energy emergency sharing scheme, and the benefits of this system I think are quite significant.

First, the system can help mitigate the economic damage that would result from an interruption of oil imports. Under the terms of that system, our partners in the IEA guarantee that in a major oil crisis the United States will not absorb a greater portion of an oil supply shortage than that which they themselves are absorbing, and it has already been noted here this morning that in the 1973-1974 Arab boycott the United States was singled out, along with the Netherlands, for an embargo.

The second benefit of our participation in the IEA is in the area of national security interests. It has long been a fundamental tenet of our national security policy that our safety is linked inextricably to that of our allies in Western Europe and the Far East. Over the years we have made substantial sacrifices and investments in support of those alliances and in our view our commitment to the IEA and its sharing system is one of the smaller of those investments.

An interruption of major proportions in oil supplies could provoke a very divisive competition for oil supplies among us and our allies. Those of our allies who are more dependent upon imports than we are, would be under strong pressure to reach accommodations of the sort that could seriously affect our ability to deal with these situations.

The IEA sharing system was designed to reinforce our alliances at a time of energy crisis and to distribute the burden of dealing with supply disruptions in an equitable manner.

The third major benefit of our participation in the IEA is in the opportunity it provides for consultation and cooperation.

Let me just cite a very brief example of that sort of cooperation, and that is the Soviet gas pipeline affair. I won't go into the details, but through the IEA and the OECD a contentious and divisive problem was successfully resolved.

I think it is fair to conclude, Mr. Chairman, that our participation in the IEA is as relevant to our security interests today as it was when the agency was created in 1974.

Let me just say a few words about the recent allocation systems test of the IEA, which Mr. Vaughan described in somewhat greater detail.

I think we have to put this test into a reasonable perspective. There have been people and articles in the press that have attempted to draw conclusions from the test which are not warranted.

First of all, as Mr. Vaughan said, the exercise was a test of procedures and not policies. Second, the test was a training exercise and provided excellent exposure to the kinds of difficult decisions we would face in a real energy crisis.

I would not suggest, Mr. Chairman, that everything went perfectly in AST-4. There has been some criticism focused on what was perceived as the danger of exclusive reliance on price to restrain demand and a lack of commitment to the IEA that that exclusive reliance might imply.

We have reassured our IEA partners, Mr. Chairman, that in fact our commitment to the IEA is as strong as ever and that we fully intend to meet our obligations under the international energy program.

We do recognize that AST-4 highlighted the need for improvement in some areas of our response procedures, and I emphasize procedures, and we intend to pursue these expeditiously.

Briefly, Mr. Chairman, our reporting companies on the question of antitrust considerations have indicated that, in the absence of the protection afforded by EPCA 252, they would not participate in the IEA's allocation information system. Extension of EPCA 252 as provided for in the legislation under discussion would permit us to continue to rely on the resource, know-how and efficiency of commercial enterprises to manage under Government supervision any oil movements which may be required.

Consequently, Mr. Chairman, we consider that extension of EPCA 252 is absolutely essential.

In conclusion, Mr. Chairman, let me just say that I think the United States is well protected against the worst effects of a major supply disruption but, at the same time, recent experience does provide us with opportunities to make further improvements in our emergency preparedness and we are working with the Department of Energy toward that end.

Thank you, Mr. Chairman, and I will be happy to try to answer any questions.

[The prepared statement of Mr. Wendt follows:]

STATEMENT OF

E. ALLAN WENDT

DEPUTY ASSISTANT SECRETARY OF STATE

FOR

INTERNATIONAL ENERGY POLICY

MR. CHAIRMAN:

I WOULD LIKE TO BEGIN BY THANKING YOU FOR THE OPPORTUNITY TO ADDRESS INTERNATIONAL ASPECTS OF THE ISSUES RAISED IN S. 1678.

I BELIEVE THIS HEARING IS TIMELY, FOR EVENTS IN THE MIDDLE EAST TODAY REMIND US YET AGAIN THAT WE CANNOT TAKE OUR ENERGY SECURITY FOR GRANTED. PERIODS OF CALM AND CONFIDENCE ABOUT OUR ENERGY SUPPLIES CAN BE RELATIVELY LONG. WE HAVE JUST GONE THROUGH A PERIOD WHEN AN OIL SHORTAGE SEEMED ONLY THE REMOTEST POSSIBILITY. BUT EACH TIME SOMETHING HAPPENS TO REMIND US THAT WE CANNOT BE COMPLACENT. TODAY, IT IS THE IRAN/IRAQ CONFLICT. WHILE NO ONE CAN PREDICT WHAT EVENTS MAY TRANSPIRE AS A RESULT OF THE IRAN/IRAQ WAR, FEW ARE WILLING TO RULE OUT THE POSSIBILITY THAT THE CONFLICT COULD AFFECT OUR ENERGY SUPPLIES. ONCE AGAIN WE MUST REVIEW OUR PREPAREDNESS FOR SUCH AN EVENT.

MR. CHAIRMAN, I WOULD STRESS TODAY THAT I BELIEVE THE U.S. IS WELL PREPARED FOR AN ENERGY EMERGENCY. WE HAVE BUILT A STRATEGIC PETROLEUM RESERVE THAT NOW AMOUNTS TO OVER 360 MILLION BARRELS. RELIANCE ON THE MARKET, SUPPLEMENTED BY USE OF THE SPR, WOULD ALLOW US SUBSTANTIAL FLEXIBILITY IN DEALING WITH AN INTERRUPTION OF OUR SUPPLIES. WE ALSO HAVE IN PLACE A MECHANISM UNDER THE INTERNATIONAL ENERGY AGENCY PROVIDING FOR COOPERATION WITH OUR ALLIES IN HANDLING THE WORST EFFECTS OF A CRISIS.

I BELIEVE YOU ARE ALL AWARE OF THE SECURITY PROVIDED BY THE SPR, ESPECIALLY IN THIS COMMITTEE. PERHAPS THIS IS AN OPPORTUNE MOMENT, HOWEVER, TO REVIEW ANOTHER MAJOR ASPECT OF OUR EMERGENCY PREPAREDNESS PROGRAM -- OUR PARTICIPATION WITH OUR ALLIES IN THE INTERNATIONAL ENERGY AGENCY EMERGENCY SHARING SYSTEM. THE BENEFITS OF OUR PARTICIPATION IN THIS SYSTEM ARE SIGNIFICANT:

FIRST OF ALL, THE IEA EMERGENCY SYSTEM PROVIDES A MECHANISM THAT MITIGATES THE ECONOMIC DAMAGE FROM AN INTERRUPTION OF OIL IMPORTS. UNDER THE TERMS OF THE IEA'S EMERGENCY OIL ALLOCATION SYSTEM, OUR IEA PARTNERS GUARANTEE THAT IN A MAJOR OIL CRISIS, THE U.S. WILL NOT ABSORB A GREATER PORTION OF AN OIL SUPPLY SHORTAGE THAN THAT WHICH THEY THEMSELVES ARE ABSORBING. FOR THIS ASSURANCE, WE IN TURN HAVE MADE A SIMILAR PLEDGE.

YOU WILL RECALL THAT THIS SYSTEM WAS ESTABLISHED IN THE WAKE OF THE 1973-74 ARAB BOYCOTT OF OIL EXPORTS TO THE U.S. AND THE NETHERLANDS. WERE SUCH AN EMBARGO AIMED AT US AGAIN, WE COULD ENCOUNTER DIFFICULTIES; HOWEVER, SUBSTANTIAL UNUSED CAPACITY AND A GREATER DIVERSITY OF SOURCES, INCLUDING SUBSTANTIAL NON-OPEC PRODUCTION, GIVE US GREATER FLEXIBILITY TODAY IN DEALING WITH POLITICALLY MOTIVATED DISRUPTIONS.

THE SECOND BENEFIT OF U.S. PARTICIPATION IN THE IEA IS IN THE AREA OF OUR NATIONAL SECURITY INTERESTS. IT HAS LONG BEEN A FUNDAMENTAL TENET OF OUR NATIONAL SECURITY POLICY THAT THE SAFETY OF THE UNITED STATES IS INEXTRICABLY

LINKED TO THAT OF ITS ALLIES IN WESTERN EUROPE AND THE FAR EAST. OVER THE YEARS WE HAVE MADE ENORMOUS SACRIFICES AND INVESTMENTS IN SUPPORT OF THOSE ALLIANCES. THE U.S. COMMITMENT TO THE IEA AND ITS SHARING SYSTEM IS ONE OF THE SMALLER OF THOSE INVESTMENTS.

MOST OF OUR ALLIES ARE MORE DEPENDENT UPON IMPORTED OIL THAN WE -- AND SOME OF OUR ALLIES ARE NEARLY TOTALLY DEPENDENT ON IMPORTED OIL. AN INTERRUPTION OF MAJOR PROPORTIONS COULD PROVOKE A DIVISIVE COMPETITION FOR OIL SUPPLIES AMONG US AND OUR ALLIES -- AND THOSE OF OUR ALLIES IN EUROPE AND THE FAR EAST WHO ARE MORE DEPENDENT UPON IMPORTS THAN WE ARE WOULD BE UNDER STRONG PRESSURE TO MAKE ACCOMMODATIONS NECESSARY TO SECURE VITAL OIL SUPPLIES. SUCH ACCOMMODATIONS COULD SERIOUSLY AFFECT OUR ABILITY TO DEAL WITH THE SITUATION, AND MIGHT WELL ALTER THE SHAPE OF OUR ALLIANCES FOR SOME TIME TO COME. THE IEA SHARING SYSTEM IS DESIGNED TO REINFORCE OUR ALLIANCES AT A TIME OF ENERGY CRISIS AND TO DISTRIBUTE THE BURDEN OF DEALING WITH DISRUPTIONS IN AN EQUITABLE MANNER.

IN ADDITION, COMPETITIVE PANIC BUYING AMONG THE MAJOR INDUSTRIALIZED COUNTRIES CAN LEAD TO EXAGGERATED PRICE RISES THAT GO FAR BEYOND WHAT THE FUNDAMENTALS OF THE MARKET WOULD SUGGEST. THE ECONOMIC DAMAGE FROM AN EXAGGERATED PRICE RUN-UP COULD BE SEVERE FOR US AND OUR ALLIES. COOPERATION, INCLUDING EXCHANGE OF INFORMATION, TOGETHER WITH SHARING AMONG THE MAJOR INDUSTRIALIZED COUNTRIES WOULD HELP CALM

MARKETS AND AVOID UNNECESSARY ECONOMIC DAMAGE. FURTHER, THE IEA AGREEMENT, AND U.S. POLICY PLACE HEAVY EMPHASIS ON INDIVIDUAL COUNTRY STOCK LEVELS. CURRENTLY MOST IEA COUNTRIES HAVE IN EXCESS OF 90 DAYS OF IMPORTS IN STOCK. THIS IS ANOTHER ELEMENT THAT WOULD CONTRIBUTE SIGNIFICANTLY TO PRICE STABILITY IN A MAJOR DISRUPTION.

THE THIRD MAJOR BENEFIT OF OUR PARTICIPATION IN THE IEA IS THE OPPORTUNITY IT PROVIDES FOR CONSULTATION AND COORDINATION AMONG GOVERNMENTS. EXAMPLES OF THIS KIND OF COOPERATION ARE MANY, BUT ONE OF THE MOST RECENT AND COMPELLING CONCERNED THE SOVIET GAS PIPELINE. A CONTENTIOUS AND DIVISIVE PROBLEM WAS SUCCESSFULLY RESOLVED THROUGH IEA EFFORTS CULMINATING IN THE ENERGY REQUIREMENTS AND SECURITY STUDY CONDUCTED BY THE COMBINED IEA/OECD SECRETARIAT. IEA AND OECD MINISTERS IN MAY OF THIS YEAR ENDORSED A SET OF POLICY CONCLUSIONS DRAWN FROM THE STUDY THAT ESTABLISH PRINCIPLES FOR THE SECURE DEVELOPMENT AND USE OF NATURAL GAS AND CREATE A FRAMEWORK FOR CONTINUED REVIEW OF GAS SECURITY ISSUES. THROUGH THIS STUDY AND FOLLOW-UP EFFORTS NOW UNDERWAY, OECD COUNTRIES ARE A GOOD DEAL MORE AWARE OF GAS SECURITY ISSUES AND ARE COMMITTED TO AVOIDING UNDUE DEPENDENCE ON ANY SINGLE SOURCE OF GAS.

THUS, I BELIEVE IT IS FAIR TO CONCLUDE THAT OUR PARTICIPATION IN THE IEA IS AS RELEVANT TO OUR SECURITY INTERESTS TODAY AS IT WAS WHEN THE AGENCY WAS CREATED IN 1974.

THE ADMINISTRATION BELIEVES THAT THE IEA MECHANISMS TOGETHER WITH THE SPR CONSTITUTE A SOUND SYSTEM FOR DEALING

WITH THE EFFECTS OF AN ENERGY CRISIS. THE RECENT ALLOCATION SYSTEMS TEST OF THE IEA (KNOWN AS AST-4) WAS DESIGNED TO REINFORCE OUR CAPABILITY TO DEAL WITH ENERGY EMERGENCIES. IT IS IMPORTANT TO PUT AST-4 INTO A REASONABLE PERSPECTIVE. MANY PEOPLE AND MANY ARTICLES IN THE PRESS HAVE ATTEMPTED TO DRAW CONCLUSIONS FROM THE TEST WHICH ARE NOT WARRANTED.

FIRST OF ALL, THE EXERCISE WAS MEANT TO BE A TEST OF PROCEDURES AND NOT POLICIES. A NUMBER OF SIMPLIFYING ASSUMPTIONS ARE REQUIRED TO CONDUCT THE TEST WHICH MAKE IT UNSUITABLE FOR USE AS A GUIDE TO POLICIES WE WOULD ACTUALLY FOLLOW IN THE EVENT OF A CRISIS. THE TEST CANNOT TELL US, FOR EXAMPLE, WHETHER WE SHOULD OR SHOULD NOT HAVE DRAWN DOWN THE SPR OR SHOULD HAVE USED A SYSTEM OF FAIR SHARING AMONG U.S. COMPANIES. WHAT IT CAN DO -- AND DID MOST SUCCESSFULLY I BELIEVE -- IS RAISE THESE EMERGENCY PREPAREDNESS ISSUES FOR PUBLIC DISCUSSION.

SECOND, THE TEST IS A TRAINING EXERCISE. PEOPLE UNFAMILIAR WITH THE IEA SYSTEM NEED TO BE TRAINED IN ITS USE. AGAIN, I THINK THIS ASPECT OF THE TEST WAS VERY SUCCESSFUL. THERE IS GREATER AWARENESS WITHIN THE U.S. GOVERNMENT TODAY ABOUT RESPONSE PROCEDURES THAN THERE WAS PRIOR TO AST-4. IT WAS AN EXCELLENT EXPOSURE FOR MANY TO THE KINDS OF DIFFICULT DECISIONS WE WOULD FACE IN A REAL ENERGY CRISIS.

MR. CHAIRMAN, I DO NOT WISH TO CONVEY THE IDEA THAT ALL WAS WELL IN AST-4. CERTAINLY, A NUMBER OF PROBLEMS AND ISSUES WERE RAISED.

AS ANY USEFUL TEST WILL DO, AST-4 UNCOVERED AREAS FOR IMPROVEMENT IN U.S. PARTICIPATION AND THUS GAVE RISE TO SOME CRITICISM OF THE U.S. PERFORMANCE IN THE TEST BOTH HERE AND ABROAD. IN FACT, I ATTENDED AN IEA GOVERNING BOARD MEETING EARLIER THIS MONTH THAT EXAMINED IN GENERAL TERMS THE RESULTS OF AST-4. WHILE THE U.S. WAS NOT NAMED DIRECTLY, CRITICISM THERE FOCUSED ON WHAT WAS PERCEIVED AS A) THE DANGER OF EXCLUSIVE RELIANCE ON PRICE TO RESTRAIN DEMAND AND B) A LACK OF COMMITMENT TO THE IEA THAT SUCH A POLICY MIGHT IMPLY. IN RESPONSE, I ASSURED OUR IEA PARTNERS OF THE CONTINUING U.S. COMMITMENT TO THE IEA. I ALSO REAFFIRMED OUR COMMITMENT TO THE FULFILLMENT OF IEA OBLIGATIONS IN A MAJOR SUPPLY DISRUPTION BY RELIANCE ON MARKET FORCES REINFORCED, IF NECESSARY, BY SUPPLEMENTAL METHODS SUCH AS SPR DRAWDOWN. THESE REASSURANCES OF OUR INTENT TO MEET OUR IEP OBLIGATIONS WERE WELCOMED BY THE OTHER MEMBER STATES. I SHOULD ALSO NOTE HERE THAT THE PERFORMANCE OF OTHER IEA COUNTRIES WAS SUBJECT TO CRITICISM AS WELL AT THIS GOVERNING BOARD MEETING, PARTICULARLY THOSE WHO WOULD USE TIGHT DOMESTIC PRICE CONTROLS IN A CRISIS.

I WOULD LIKE TO RESTATE HERE THE ADMINISTRATION'S CONVICTION THAT OUR BASIC APPROACH TO EMERGENCY PREPAREDNESS IN ENERGY IS SOUND. TO BE SURE, THERE MAY BE ROOM FOR IMPROVEMENT IN PROCEDURES AND WE ARE NOW EXAMINING HOW SUCH IMPROVEMENTS MIGHT BE MADE IN THE CONTEXT OF OUR PRIMARY RELIANCE ON MARKET FORCES. FOR EXAMPLE, THE MAJORITY OF

LARGE U.S. OIL COMPANIES ON WHICH THE IEA WOULD RELY IN A CRISIS HAVE INDICATED THEY WOULD BE ABLE TO COOPERATE ON A VOLUNTARY BASIS ONLY IF THEY HAD ASSURANCES THAT THE BURDEN OF SUCH COOPERATION WITH THE IEA WOULD BE SHARED PROPORTIONATELY WITH OTHER COMPANIES, I.E., IF SOME KIND OF FAIR SHARING SYSTEM EXISTS. THE ROLE OF THE SPR IN THE VOLUNTARY OFFER PROCESS IS UNDER CAREFUL REVIEW. USING A SYSTEM OF DIRECTED SUPPLY ORDERS TO VARIOUS COMPANIES, WHICH IS ENVISAGED UNDER SECTION 251 OF THE ENERGY POLICY AND CONSERVATION ACT (EPCA), COULD ALSO PROVIDE THE BASIS FOR SUCH A FAIR SHARING SYSTEM.

THE ADMINISTRATION IS ALSO FIRM IN ITS INTENTION TO MEET THOSE IEA REQUIREMENTS REFERRED TO AS DEMAND RESTRAINT. ONE METHOD OF MEETING THESE COMMITMENTS WOULD BE TO DRAW UPON THE STRATEGIC PETROLEUM RESERVE TO AUGMENT SUPPLIES IF THE IEA SYSTEM IS TRIGGERED. ANOTHER WOULD BE SYSTEMATIC ENCOURAGEMENT OF THE PUBLIC TO CONSERVE ENERGY VOLUNTARILY, IF ECONOMICALLY JUSTIFIED.

MY POINT HERE IS THAT THE ADMINISTRATION RECOGNIZES THAT AST-4 HIGHLIGHTED THE NEED FOR IMPROVEMENT IN SOME AREAS OF OUR RESPONSE PROCEDURES AND WE INTEND TO PURSUE THESE EXPEDITIOUSLY.

AS I INDICATED ABOVE, THE IEA PROVIDES A SYSTEM WITHIN WHICH WE AND OUR ALLIES CAN COOPERATE TO ALLEVIATE THE EFFECTS OF SEVERE OIL CRISES AFFECTING ALL OR ANY OF US.

THE IEA SYSTEM COULD HAVE BEEN DESIGNED TO HAVE EACH GOVERNMENT MANAGE ITS NATION'S PARTICIPATION IN THIS SYSTEM, BUT WE AND MOST OF OUR IEA PARTNERS RECOGNIZED IN THE BEGINNING THAT GOVERNMENTS DO NOT MANAGE COMMERCIAL OPERATIONS VERY WELL. OVER NEARLY TEN YEARS WE HAVE THEREFORE DEVELOPED A SYSTEM THAT ENSURES THE COOPERATION AND HELP OF THE COMPANIES -- THOSE WHO NORMALLY CONDUCT THE BULK OF INTERNATIONAL OIL TRADE -- TO MAKE THE ALLOCATION SYSTEM WORK. THIS HELP IS ESSENTIAL. TO PARTICIPATE IN A COOPERATIVE SYSTEM OF THIS KIND, HOWEVER, U.S. COMPANIES NEED ANTI-TRUST PROTECTION. EPCA 252 PROVIDES AUTHORITY FOR EXTENDING AN ANTI-TRUST DEFENSE TO COMPANIES PARTICIPATING IN THE IEA SYSTEM. AS NOTED BY PRESIDENT REAGAN, "A COORDINATED RESPONSE TO ANY INTERNATIONAL OIL SUPPLY DISRUPTION THROUGH THE IEA REQUIRES COOPERATION BY PRIVATE AMERICAN OIL COMPANIES IN WAYS THAT ARE NOT POSSIBLE ABSENT (THE STATUTORY AUTHORIZATION CONTAINED IN EPCA 252)." NATURALLY, EPCA 252 ALSO ESTABLISHES SAFEGUARDS TO ASSURE THAT THIS DEFENSE IS NOT ABUSED.

WITHOUT EXCEPTION, U.S. REPORTING COMPANIES HAVE STATED THAT, WITHOUT THE PROTECTION AFFORDED BY EPCA 252, THEY WOULD NOT PARTICIPATE IN THE IEA'S ALLOCATION AND INFORMATION SYSTEMS. THUS, TO ALLOW EPCA 252 TO LAPSE WOULD SHIFT FROM THE COMPANIES TO THE U.S. GOVERNMENT THE BURDEN OF ORGANIZING MOVEMENT OF OIL TO FULFILL U.S. OBLIGATIONS UNDER THE IEA EMERGENCY OIL ALLOCATION SYSTEM. EXTENSION OF EPCA 252 WILL

PERMIT US TO CONTINUE OUR RELIANCE ON THE RESOURCE, KNOW-HOW, AND EFFICIENCY OF COMMERCIAL ETNERPRISES TO MANAGE, UNDER GOVERNMENT SUPERVISION, ANY OIL MOVEMENTS WHICH MAY BE REQUIRED.

THERE IS ONE OTHER ELEMENT OF EMERGENCY PREPAREDNESS ON WHICH I WOULD LIKE TO COMMENT. AS I NOTED IN THE BEGINNING OF MY REMARKS, THE DEVELOPMENT OF THE STRATEGIC PETROLEUM RESERVE IS A CRUCIAL PART OF OUR IMPROVED EMERGENCY PREPAREDNESS. WE CURRENTLY HAVE 360 MILLION BARRELS OF OIL IN STORAGE, AND WE PLAN TO REACH 750 MILLION BARRELS OF CRUDE BY 1990. RECENTLY, DOE CONDUCTED AN EXTENSIVE TEST, CALLED DIREX-B, OF BOTH THE PLANNING AND POLICIES NEEDED TO USE THE SPR AND THE PROGRAMS PROPOSED TO IMPLEMENT SALES AND DELIVERY OF OIL TO SERVE THE NATIONAL NEED. WE UNDERSTAND THAT AN ASSESSMENT OF DIREX-B BY OUTSIDE EXPERTS CONCLUDES GENERALLY THAT THE DELIVERY SYSTEM WILL WORK, THAT MINOR IMPROVEMENTS CAN BE MADE, AND THAT CERTAIN CHANGES IN THE SALES PROCEDURES, IF MADE, WOULD PROMOTE AND ENHANCE THE SUCCESS OF THE SALES EFFORT TO MOVE SPR OIL INTO THE MARKET.

I WOULD CONCLUDE., MR. CHAIRMAN, THAT UNITED STATES IS WELL PROTECTED AGAINST THE WORST EFFECTS OF A MAJOR SUPPLY DISRUPTION. AT THE SAME TIME RECENT EXPERIENCE PROVIDES US WITH OPPORTUNITIES TO MAKE FURTHER IMPROVEMENTS IN U.S. ENERGY EMERGENCY PREPAREDNESS, AND WE ARE ALREADY WORKING WITH THE DEPARTMENT OF ENERGY TOWARDS THAT END.

MR. CHAIRMAN, THAT CONCLUDES MY STATEMENT. I WILL BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE. THANK YOU.

The **Chairman**. Thank you very much.

It's not my intention to try to limit the participation of any member of the committee, but in order to fairly allocate the time I think if we would limit ourselves to 10 minutes the first round and then go to the second round of questions we will try to accommodate all members.

Senator **Metzenbaum**. I hope the Chair understands that my questions will go far beyond 10 minutes.

The **Chairman**. I have no doubt.

Senator **Matsunaga**. Can we have the 5-minute rule?

The **Chairman**. I thought we would use 10. If you want to use 5, it would be all right.

First of all, let me comment at the outset that I don't want the administration, or anyone listening to this discussion today, to be under any misapprehension regarding my own preferences.

I thought that the action the Congress took earlier with respect to standby authority was the preferable course. I recognize, however, that the administration has different views. The President vetoed that legislation and the Congress did not override that veto.

That is a matter of disappointment to me that we did not come to an agreement at that time. I still remain convinced that we should have strengthened our emergency response mechanisms.

The bill before us today does not represent my best view of what the policy ought to be, but it does represent the best accommodation that could be reached between myself and others in the Congress and the administration with respect to strengthening those responses. While the bill does not go nearly as far as I think we should go, it does go as far as we can go with administration support. I introduced it in that light and I want it understood in that light.

Second, I believe that we ought to take a look at the International Energy Agreement, its context, its background and what it is intended to do. And, Secretary Wendt, I appreciate your comments with respect to its importance to us. I'm sure you will be questioned with that in mind.

I want to explore for just a moment in terms of philosophy, in terms of reactions.

Secretary Vaughan, you heard Senator Durenberger earlier today recite an administration position or a response to AST-4. His comments appear at the bottom of page three of his prepared remarks.

I am in possession of letters which bear your signature addressed to some of the participants in that test and that comment that he quoted appears to be a direct comment or direct quote from your letter.

You did say in that letter that this is a significant achievement. I might read that letter, that quotation, in the context of the paragraph, which gives it a slightly different meaning than was implied in Senator Durenberger's statement, but I think it could be interpreted by people as he did. I think it is subject to that interpretation, particularly if you read it in context with the last sentence in the preceding paragraph in that letter, which says, "I am delighted to report to you that this effort was a resounding success."

I think it might be useful if you could at this time indicate what you think was successful about it because it has been roundly criticized by many.

Mr. VAUGHAN. Mr. Chairman, I think what was successful about it was, first, that it was a training exercise designed to principally train people in test procedures, and after all an exercise is supposed to find and identify problem areas, and in that respect it was certainly successful.

We did train people. It had been several years since an AST had been conducted. Changes had occurred in the administration. As I say, in the training sense, it was quite succesful.

In the sense of identifying problems and information and procedure points that would be troublesome when you were in the situation for real, it was quite useful and helpful and we look forward to working with the IEA staff through our State Department in making these procedures even more streamlined.

In the context of that series of letters, I believe that this exercise was particularly successful in introducing for the first time into the international oil sharing system so-called nonreporting companies and the overwhelming response we had.

As I pointed out in my testimony, that response came from companies that did not receive antitrust protection, et cetera, and yet did participate in the test, expended their resources to participate in the test and, as the record indicates, we received a huge response. I think only in the sense that it was a huge response, where the volumes offered were quite large, I was justified in saying it was a success.

Had it been a very, very narrow margin, I think that would have been gilding the lilly, but it was not.

The CHAIRMAN. Many people have focused on the numerical results as the proof of whether it was good or bad, and I think most people who pay any attention to the subject at all now know that, under the assumptions in that test and under the parameters of that test, it was assumed the price would rise to $98 a barrel and that there would be no response with respect to use of SPR oil, on the use of economic measures to try to reduce that cost.

Would you say that that is a matter of administration policy, that we would allow the price to rise to $98 a barrel in an effort to have the market allocate supply?

Mr. VAUGHAN. No, sir, and I don't think that is a correct interpretation of the results of that test.

In the first place, the $98 was a purely mechanical calculation in the sense of using models and taking the parameters of the test set by the IEA test design committee, plugging them in and running them through the computer.

The prime factor that drove the price up was the assumption involved in setting up the test that called for governments not to react for the first several months of the test scerano. That is a substantial departure from the real world. I don't think this administration has ever indicated it wasn't trying to stay continuously on the situation and certainly would seriously consider early response.

The CHAIRMAN. Are you telling us then that the test was a hypothetical situation?

Mr. VAUGHAN. Absolutely.

The **Chairman**. And that the administration would have responded in some way prior to the time the price rose to $98 a barrel?

Mr. **Vaughan**. Certainly we would try, Mr. Chairman. I can't guarantee you any particular method would be successful, but it would be the height of irresponsibility not to try.

The **Chairman**. Secretary Wendt, you had indicated, I believe, that if the price rose to $98 a barrel, which was the result of the assumed conditions in that test, that it would be a severe economic blow to the economies of several countries that were involved in that test. Am I correct?

Mr. **Wendt**. Mr. Chairman, I'm not sure exactly what you are referring to. I don't think I said that in my testimony, but in any event I can address the question.

Certainly oil at that price would create serious economic problems for a number of countries.

The **Chairman**. Well, you've had reviews and you've also sat with other countries and looked at that test. Haven't they commented with respect to what would happen if price rose to $98 a barrel?

Mr. **Wendt**. Yes, they have, Mr. Chairman. They were seriously concerned.

The **Chairman**. They didn't take that as a benign result.

Mr. **Wendt**. They did not take that as a benign result. That is certainly correct.

The **Chairman**. Did you?

Mr. **Wendt**. As Mr. Vaughan just noted, this was a mechanical exercise. It was not meant to indicate what would happen in the real world and does not suggest for one moment that this is a result the administration would permit to take place.

The **Chairman**. Well, in the real world, and that's where we live, I guess—maybe Washington, isn't the real world—but I think it can be anticipated that when the test shows as its results that the price ran to $98 a barrel and all of you fellows were sitting around there watching those figures come out of the computers and discussing them that somebody would assume that that was what you intended to happen.

Are you telling us today that that's not what you intended to happen and that it is your view that through the IEA, and whatever other mechanisms we have, not only would the pressure upon us be severe but that we would react?

Mr. **Wendt**. In my judgment, Mr. Chairman, we would react.

The **Chairman**. Thank you very much. I think my time has expired.

Senator Metzenbaum?

Senator **Metzenbaum**. The wire ticker just indicated that the Strait of Hormuz are closed. What are you going to do about it this afternoon? Of course, I made this up. What are you going to do about it?

Mr. **Vaughan**. In the first place, Senator, if they are closed, the first thing we are going to have to try to find out is how long do we think they are going to stay closed.

Senator **Metzenbaum**. Looks like they're going to be closed for a long time.

Mr. VAUGHAN. All right, they're going to stay closed for a long time. We then need to find out what is going to happen to the flows of oil from that part of the world. If you're going to cut it all off, there are pipelines, and there are other suppliers not dependent on the Straits.

Senator METZENBAUM. What are you going to do about it? You're just going to find out about it and then you're going to just sit back?

Mr. VAUGHAN. Once we find out what we think the flows of oil will be, then I think we must consult with our allies through the IEA. Undoubtedly if the straits are closed and expected to be closed for a long period of time and not able to be reopened, and I would point out there are options that are not energy options, trying to maintain the straits open or reopen them or keep them open, there are other options that any administration would have.

Senator METZENBAUM. What?

Mr. VAUGHAN. Well, to escort ships through the straits.

Mr. METZENBAUM. You may not be able to get through the straits. Let's assume that oil is cut off and let's not talk about the military options. Let's talk about what happens to our country.

There is a closing of the Hormuz Strait. What are you and the Energy Department going to do about it in order to keep the $98 a barrel from becoming a reality, in order to keep 2 million people from becoming unemployed, in order to keep inflation from rising.

What will you do as the person in charge of that and what do you plan to do? You have no allocation authority. If you are going to sell the SPR oil, you indicated you would sell it at market price. So what are you going to protect the country?

Mr. VAUGHAN. You've already mentioned one of the major responses that is possible, Senator, and that is the use of SPR. That can be auctioned.

Senator METZENBAUM. That would be sold to the highest bidder.

Mr. VAUGHAN. It is the policy of the administration to auction the oil, yes, sir.

Senator METZENBAUM. So that when the other countries indicated that they did not take your study as a benign result and indicated their concern, you here in this country making energy policy really would be guilty of that phrase that was used in an earlier administration of benign neglect because you don't have any program at all to act, do you?

Mr. VAUGHAN. I disagree with that, sir. I think reacting with the SPR——

Senator METZENBAUM. The SPR is sold at the market price but——

Mr. VAUGHAN. If you are selling SPR oil, Senator, at the market price, that should drive prices down. Certainly if it is sold early on it is the expectation of many of those who view our markets that it will have the effect of reducing price fights and will, therefore, not only benefit this country but our allies.

Senator METZENBAUM. Isn't it the fact that some oil companies would almost be totally without any oil supply if the Strait of Hormuz were closed and we would at that point be required, assuming a 7-percent worldwide shortage occurred, to give up 1.3 million barrels of oil a day for our allies, and I don't quite understand what you are going to do as far as specific programs.

Mr. **Vaughan**. What you are referring to, Senator, is the obligations this country has taken under the international energy program to cooperate with our allies and try to act together to ease the harm.

I think it is important in any severe shortage to recognize that one does not have the option of avoiding the harm, totally. It is impossible. There will be some impacts. It's just a matter of how they are shared, and one of the things that this country has entered into, and which I think is a sound decision, is an agreement to work with its allies in trying to mitigate that harm among the free world.

Senator **Metzenbaum**. Tell me, Mr. Vaughan, why it was in our Nation's interest to be working with our allies to give up 1.3 million barrels of oil a day. Some of those countries may need it. Some may not. It will have a more drastic impact upon our economy than on theirs. Why is it in our interest?

Mr. **Vaughan**. I think, Senator, it's in our interest because we live in an economically interdependent world and that is particularly true in the free world. We cannot ignore what happens in other parts of the world, particularly those who are of similar views and allied with us, and I think it is that cooperation and leadership that is essential.

It is true, Senator, that under the IEA we are all storing oil, and to the extent we can cooperate we have even more power against those who would blockade us or that sort of thing.

Senator **Metzenbaum**. Why didn't you plan to sell any SPR oil during the AST-4 test?

Mr. **Vaughan**. What happened in AST-4, Senator, is that the scenario fixed the period of time that we were to play the test and that was spring 1981.

At that point in time, this country had a strategic petroleum reserve only slightly over 100 million barrels. The scenario of the test included a shortage of indeterminate length and indeterminate origin.

We felt under those circumstances that we would not be planning realistically if we ignored the likely military situation and demands by our national security element under a situation where you do not know the cause or the length of the shortage and where the reserve was so small.

That is why we made the decision not to use the SPR in AST-4.

Senator **Metzenbaum**. Is a sharing plan viable in the middle of a crisis? In other words, if the American people let you allocate 1.3 million barrels of oil a day while they are standing in line or, in some instances, unable to pay for the cost of their heating oil, will the American people support that kind of a decision?

Mr. **Vaughan**. Senator, it is my view that the American people have on a number of occasions in the past rather willingly extended significant portions of their wealth and effort to supporting their allies and operating cooperatively in the world, and I believe that properly led by the Congress and the President they would be willing to do that again because I believe that this approach through IEA is an approach to share the harm and mitigate it in a cooperative fashion rather than simply go it alone.

Senator **METZENBAUM**. Mr. Vaughan, what would you do for hospitals, fire and police departments, and other emergency services to see that they get a supply of oil?

Mr. **VAUGHAN**. We believe that our programs do several things in that regard, Senator. First, we have encouraged those elements of society, along with all others, to take care of themselves and look to the future, stockpile.

Senator **METZENBAUM**. Do you think that any of them at this moment have done so?

Mr. **VAUGHAN**. Yes, some have, Senator.

Senator **METZENBAUM**. Do you know if some hospitals, some fire——

Mr. **VAUGHAN**. I know of some municipal governments that have, and that includes fire, police.

Senator **METZENBAUM**. Would you not agree that the vast majority have not because they haven't had the funding to do it?

Mr. **VAUGHAN**. I would agree that the vast majority have not.

Senator **METZENBAUM**. What would you do for them?

Mr. **VAUGHAN**. In addition to encouraging stockpiling, we have worked with elements of society such as you mentioned in encouraging cooperative purchasing, and to assist in some cases with the actual importation of supplies and the use of refining agreements. That is another approach.

We also through this legislation have recommended that States be allowed to create a set-aside, and I believe that is in this legislation and we are supporting that. That set-aside would permit up to 5 percent of the oil sold in the State, if the Governor and legislature so agreed, to be used for directed purposes.

We created a provision in the SPR drawdown plan for up to 10 percent of any drawdown to be used for directed purposes. I think there are a variety of methods available.

Senator **METZENBAUM**. Assuming that something were to occur immediately. The farmers of this country have no stockpile. They haven't been engaged in cooperative purchasing. The industries of this country have at the most stockpiled a very minimum amount. The emergency services about which we speak, the vast majority have not done anything. The educational institutions or our country have not done anything, and certainly the people of this country who need to heat by oil and need to drive their automobiles back and forth to work have not been able to do anything.

What are you going to do for all of them?

Mr. **VAUGHAN**. Senator, again, we would encourage stockpiling. For example——

Senator **METZENBAUM**. No; I'm talking about not encouraging it. It's after the fact. I'm now giving you the presupposition that the Strait of Hormuz have been closed and it is now your responsibility to do something to keep America moving with respect to all of these segments I spoke about.

Not encouraging, because you're not doing any encouraging today and neither is anybody else, but what are you going to do today when the Strait of Hormuz are closed?

Mr. **Vaughan**. First, Senator, by allowing the marketplace to work, we get the most efficient distribution of what is available.

We believe our system of oil companies is much better able to direct distribution than any system of bureaucrats one could devise. For 10 years we tried to use the Government to do this, and it didn't work.

Second, we have an SPR. The SPR can be used and as I have already mentioned directed sales are available.

Senator **Metzenbaum**. Let me ask you on that score. Didn't you say that SPR could be used in time of an emergency before Congressman Synar's committee, and didn't the Secretary subsequently say no? Didn't he come up with contrary position, saying that SPR would not be used in time of an energy shortage to alleviate price increases?

Mr. **Vaughan**. I am unaware, Senator, of any position that says that the SPR cannot be used in time of emergency. You may be referring to remarks that SPR will be used as a supply supplement, but since supply and prices and demands are interlinked, that's just verbiage, I think.

Senator **Metzenbaum**. I'll come back to Mr. Hodel's statement before we conclude.

During the AST-4, the United States actually increased its fill ratio of the SPR to 500,000 barrels a day. If that is our policy, why don't we fill SPR at a higher rate now when prices are down?

Mr. **Vaughan**. The simple answer to your question, Senator, is we do not think we can afford it.

Senator **Metzenbaum**. Do you think you could afford it when prices go up to $98 a barrel?

Mr. **Vaughan**. No, we won't be able to afford it at that moment, either, Senator, and even less so.

When I say not afford it, when one puts together a Federal budget, which you know better than I is a very complex and difficult task, one does have to balance between the needs of the Nation. The President has done that.

We believe that in making the decisions that the administration did about the level of funding for SPR, it did not unduly risk the Nation's energy welfare. We are at about the same level of risk we anticipated when the SPR program was set up.

Senator **Metzenbaum**. We're talking about 500,000 barrels a day during that test. Current law mandates 300,000 barrels a day. The Interior appropriations bill calls only for 186,000 barrels a day, at the administration's insistence, and the chairman of the committee's proposal is to reduce the authorization to 145,000 barrels a day.

Now what policy should we be following?

Mr. **Vaughan**. We believe simply put, the policy we should follow on SPR fill, Senator, is the maximum fill we as a Nation believe we can afford in any given budget year and I think that has been the policy of this administration from its beginning and it remains the policy. The number has dropped in the last year because we believe the money is more sorely needed for other purposes.

Senator **Metzenbaum**. Do you not think—do you think that our Nation's security might be endangered if we don't have SPR sufficiently filled and that we might take a look at the fill rate in comparison to our expenditures for defense programs? Don't you think they both have to do with our national security?

Mr. VAUGHAN. I think they certainly do, Senator, and I think the Commander in Chief, the President, did exactly that when he made the decisions he did in filing his budget. That's a tough decision, and I fully support it. I think from an energy point of view it was a reasonable tradeoff.

I do not believe we are at any greater risk today because of that decision. After all, it is this administration that has virtually tripled the size of the SPR; we are almost half full now and we have not been in office a full term.

As you know, the strategic petroleum reserve existed as a program for some 5 years before this administration took office and only 110 million barrels had been accumulated.

The CHAIRMAN. Thank you very much.

I wanted to ask two or three questions on international energy sharing and also with respect to our own emergency responses.

I have before me a CIA report, the International Energy Statistical Review, as well as the DOE Monthly Energy Review, dealing with stocks in various countries.

[Insert at request of the chairman follows:]

Directorate of
Intelligence

International Energy Statistical Review

27 September 1983

DI IESR 83-009
27 September 1983

Selected OECD Countries: Oil Stocks

Thousand Barrels, End of Month

		United States [a]	Japan [b]	Canada	Belgium	Denmark	France	Ireland	Italy
1973	Sep	1,057,911 [c]	322,000	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
1975	Mar	1,076,360	314,000	N.A.	45,968	34,770	N.A.	7,636	136,890
	Jun	1,071,150	335,000	N.A.	44,983	34,867	N.A.	7,899	142,335
	Sep	1,147,338	354,000	N.A.	51,644	44,333	254,296	7,716	152,490
	Dec	1,111,810	348,000	N.A.	51,538	43,836	222,051	6,293	142,153
1976 [d]	Mar	1,060,489	314,000	145,249	42,340	36,281	191,245	5,913	117,380
	Jun	1,093,550	347,000	158,304	47,167	35,003	202,684	6,563	132,882
	Sep	1,191,450	387,000	157,670	48,165	42,053	239,265	6,570	141,496
	Dec	1,111,810	377,000	149,784	40,077	41,296	231,133	6,008	140,773
1977	Mar	1,086,822	349,000	140,290	41,508	36,354	209,868	5,869	135,692
	Jun	1,195,068	385,000	157,560	49,589	39,456	201,130	7,066	162,381
	Sep	1,303,369	402,000	162,140	57,371	46,340	[illegible]	6,979	163,958
	Dec	1,311,900	407,000	163,804	51,618	46,107	234,629	7,677	159,972
1978	Mar	1,167,810	383,000	144,824	42,961	39,259	194,640	7,906	135,692
	Jun	1,185,124	396,000	148,534	42,756	40,610	187,632	7,563	142,240
	Sep	1,262,932	392,000	152,811	43,121	45,698	213,715	8,183	157,795
	Dec	1,277,619	411,000	141,524	43,508	47,056	198,166	8,212	150,164
1979	Mar	1,142,427	380,000	129,626	38,989	36,478	184,347	7,964	135,481
	Jun	1,209,747	392,000	139,445	45,333	36,522	199,239	8,140	147,226
	Sep	1,308,802	437,000	147,305	42,309	46,647	229,293	8,366	165,739
	Dec	1,340,868	461,000	146,630	48,370	44,150	222,066	8,497	173,496
1980	Mar	1,341,855	429,000	145,067	53,589	42,632	237,965	8,689	154,526
	Jun	1,410,388	473,000	160,943	50,815	43,953	240,060	9,264	166,462
	Sep	1,446,519	509,000	177,088	54,889	43,574	269,326	9,548	196,392
	Dec	1,395,259	498,000	160,211	56,487	42,756	239,265	8,753	169,462
1981	Mar	1,405,496	448,000	154,721	50,896	40,077	215,328	8,979	157,096
	Jun	1,437,996	492,000	168,506	47,713	40,216	213,854	7,928	171,185
	Sep	1,480,658	491,000	173,484	47,479	41,574	228,811	7,767	188,048
	Dec	1,488,533	480,000	158,726	50,859	38,413	209,963	7,154	168,236
1982	Mar	1,400,902	478,000	148,853	36,434	37,602	193,903	6,322	158,468
	Jun	1,362,266	474,000	132,043	40,550	36,259	190,508	6,504	156,880
	Sep	1,433,736	467,000	130,639	40,318	37,434	204,575	6,811	180,317
	Dec	1,462,017	449,000	132,545	38,222	36,894	189,544	6,497	179,478
1983	Mar	1,370,790	434,000	128,556	N.A.	34,814	158,421	6,731	154,928
	Apr	1,361,800	431,000	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
	May	1,397,300	427,000	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
	Jun	1,409,258	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.

		Luxembourg	Netherlands	Norway	Portugal	Spain	Switzerland	Turkey	United Kingdom	West Germany
1973	Sep	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
1975	Mar	569	82,724	12,594	N.A.	61,393	27,636	9,636	N.A.	146,882
	Jun	504	82,758	11,921	N.A.	58,845	28,368	10,957	N.A.	151,494
	Sep	548	83,614	13,563	6,541	61,743	30,332	11,271	N.A.	170,083
	Dec	511	80,059	13,702	5,876	59,181	30,565	6,979	N.A.	184,004
1976	Mar	438	71,336	16,958	8,556	57,874	28,380	10,424	145,555	165,788
	Jun	584	71,744	18,980	7,680	66,211	29,375	10,108	156,417	172,944
	Sep	584	84,315	17,168	7,008	68,240	30,580	9,870	163,323	190,815
	Dec	808	80,190	17,454	9,176	66,897	32,230	11,680	163,111	204,787
1977	Mar	650	75,438	14,133	8,745	77,760	32,018	8,475	146,518	203,342
	Jun	680	83,388	15,936	9,689	81,694	34,500	14,089	155,864	201,677
	Sep	608	86,819	17,009	9,132	77,701	33,222	10,614	157,768	216,971
	Dec	650	79,985	18,805	11,147	77,833	35,573	N.A.	145,965	230,877
1978	Mar	657	66,094	15,651	8,198	67,759	34,522	N.A.	148,161	211,518
	Jun	591	69,007	15,739	10,585	76,650	34,536	N.A.	151,395	213,861
	Sep	496	63,386	18,965	11,176	80,344	36,157	N.A.	152,139	227,395
	Dec	664	76,388	16,549	6,701	74,467	36,945	N.A.	155,359	235,608
1979	Mar	599	61,583	15,096	11,498	71,299	37,558	N.A.	157,422	228,738
	Jun	628	70,343	16,279	13,600	71,533	37,931	N.A.	148,497	243,353
	Sep	745	81,796	16,337	12,598	84,381	39,055	8,475	167,564	265,735
	Dec	810	85,505	16,191	10,979	77,351	39,980	5,950	166,884	268,604
1980	Mar	796	96,462	16,345	13,972	81,305	38,908	8,694	159,585	291,657
	Jun	761	101,850	19,549	19,119	90,956	38,683	9,402	170,689	304,446
	Sep	761	109,814	21,258	18,987	101,966	39,668	9,731	170,243	298,585
	Dec	854	110,332	19,053	23,053	76,665	41,449	8,519	165,812	314,499
1981	Mar	881	99,273	19,447	23,345	85,381	40,043	12,930	160,133	311,009
	Jun	818	100,492	19,834	23,433	98,470	39,384	11,534	155,556	305,768
	Sep	832	100,380	17,761	20,374	96,287	39,873	9,892	147,380	301,972
	Dec	803	94,944	14,739	19,887	86,670	40,898	12,987	139,963	291,082
1982	Mar	745	86,074	18,403	19,418	80,869	39,433	10,950	131,604	273,932
	Jun	759	93,243	16,936	18,922	87,074	40,844	14,644	138,131	309,167
	Sep	694	86,169	16,084	21,380	86,950	41,084	10,565	134,210	275,590
	Dec	808	93,046	19,929	18,584	79,750	40,048	10,585	122,093	267,533
1983	Mar	745	86,865	20,309	N.A.	77,555	40,486	15,350	116,815	256,610

[a] US stocks include Strategic Petroleum Reserves (SPR). According to DOE, the SPR held approximately 340.7 million barrels as of 31 Jul 1983.

[b] Japanese stocks include government-owned strategic stockpiles estimated at about 78.68 million barrels as of Jul 1983.

[c] Estimated.

[d] As of January 1977, US Bureau of Mines changed the reporting of crude oil stocks to include foreign crude oil not yet received at refineries. Figures beginning in 1976 have been computed on the new basis.

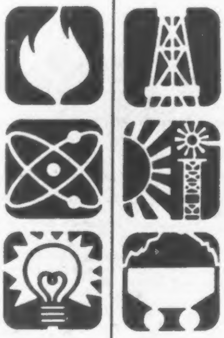
DOE/EIA-0035(83/09)

Monthly Energy Review

September 1983

Energy Information Administration
Washington, D.C.

First Half 1983 Summary
See Executive Summary



International

Petroleum Stocks for Major Non-Communist Industrialized Countries at End of Period[1]

		Canada	France	Italy	Japan	United Kingdom	United States	West Germany	Other OECD[2]	Total OECD[3]
						Million barrels				
1973		149	203	NA	303	156	1,008	NA	NA	NA
1974		164	240	169	370	181	1,074	215	NA	NA
1975		167	239	143	375	164	1,133	190	NA	NA
1976		156	231	142	384	165	1,112	214	NA	NA
1977		170	241	162	389	147	1,312	236	485	3,152
1978		148	214	153	422	147	1,278	239	487	3,089
1979		155	231	163	457	163	1,341	273	574	3,358
1980		171	254	173	481	169	1,392	323	610	3,573
1981	January	169	234	155	479	168	1,388	319	NA	NA
	February	162	235	184	457	170	1,369	312	NA	NA
	March	165	227	158	452	164	1,401	317	581	3,465
	April	174	235	169	434	165	1,415	322	NA	NA
	May	176	229	173	496	162	1,438	321	NA	NA
	June	179	225	171	484	158	1,430	312	598	3,557
	July	179	228	177	476	153	1,439	305	NA	NA
	August	184	233	189	483	151	1,457	308	NA	NA
	September	181	241	187	493	151	1,476	307	591	3,627
	October	172	238	188	500	149	1,485	303	NA	NA
	November	163	230	178	483	147	1,501	300	NA	NA
	December	164	222	167	486	145	1,484	297	575	3,520
1982	January	163	222	165	464	NA	1,461	290	NA	NA
	February	156	215	162	460	NA	1,431	290	NA	NA
	March	149	207	158	480	133	1,401	279	524	3,331
	April	148	201	154	483	NA	1,350	312	NA	NA
	May	147	193	154	484	NA	1,349	310	NA	NA
	June	131	200	156	478	141	1,362	288	541	3,297
	July	130	205	160	460	134	1,394	298	NA	NA
	August	137	207	179	470	139	1,407	311	NA	NA
	September	131	212	179	472	137	1,415	290	548	3,374
	October	135	212	177	471	135	1,434	279	NA	NA
	November	136	213	174	472	130	1,456	280	NA	NA
	December	133	201	179	469	125	1,429	273	542	3,351
1983	January	136	206	170	473	125	1,453	274	NA	NA
	February	133	187	163	450	121	1,432	274	NA	NA
	March	127	R166	155	427	120	1,375	262	R534	3,166
	April	123	R158	151	422	118	1,376	255	NA	NA
	May	125	164	152	437	121	1,397	274	NA	NA

[1] Petroleum stocks include crude oil (including strategic reserves), unfinished oils, natural gas plant liquids, and refined products. Petroleum stocks include all nonmilitary petroleum held for storage, regardless of ownership, within each country in bulk terminals, refinery tanks, pipeline tankage, intercoastal tankers, tankers in port, and inland ship bunkers. Data exclude oil held in pipelines (except for the United States), rail and truck cars, sea-going ships' bunkers, service stations, retail stores, and tankers at sea.

[2] "Other OECD" includes Organization of Economic Cooperation and Development (OECD) members not shown.

[3] The members of OECD are listed in Note 2 on the last page of this section.

R=Revised data. NA=Not available.

Notes: • U.S. geographic coverage is the 50 States and the District of Columbia.
• Totals may not equal sum of components due to independent rounding.
Sources: • See the last page of this section.

The CHAIRMAN. Some of the countries that are members of IEA use different mechanisms than we do. We have as our major mechanism the strategic petroleum reserve. Others have taken actions to enhance the opportunity, advisability, or requirement that stocks in private hands be maintained at higher levels. We have elected in this country not to do that.

The result has been that in this country, if I read it correctly, the burden of bearing those reserves has shifted from the private sector to the public sector, and that seems to me to be counter to what the administration generally believes ought to happen.

Am I wrong in that assumption?

Mr. VAUGHAN. Certainly bearing the burden of the strategic petroleum reserve in this country is a public activity as opposed to a private activity.

However, I think the same taxpayer/consumer bears the burden in any country of stockpiling, ultimately.

The CHAIRMAN. I don't question that, but other countries have taken actions to enhance the stocks held in private hands.

Mr. VAUGHAN. Yes, they have, Senator. As you know I have testified before this committee from the start that this Administration is very interested in increasing private stocks.

One of the main things we did was remove price and allocation controls, which we thought were the main disincentive, and we thought that was the most effective action. But your legislation, sir, I think provides some more encouragement to private stockpiling through the feature which makes it clear that the government is not going to grab private stockpiles. It's going to allow those who take care of themselves to benefit from that preparation, and we applaud you in that.

I think we will see stocks increase, particularly as our economy returns to higher levels of vigor. It is expensive, as you know, to store oil.

The CHAIRMAN. I hope you both, from your respective agencies' points of views, can respond to this question in writing. I'll not take the time to do it right now nor do I suspect that you would have the figures on the top of your head in every instance.

I would like to know the oountries that are participants in the IEA arrangements and, at the same time, but not necessarily the same list, what our trading partners in the world have done with respect to government policies to enhance the stocks held in their country, for example, in Japan with government-owned stocks, and in the case of Italy mandated stocks in nongovernmental hands.

I'll just go through the list and I'll refer to the CIA Statistical Review here. From 1973 through 1983, the United States has increased stocks, but those stocks are almost exactly the increased amounts in SPR.

In Japan the stocks have increased. Again that increase if I recall correctly is about two-thirds government-owned stocks and the balance is stocks in nongovernment hands.

Canada, stocks have notably gone down. In Belgium, the stocks are down. In Denmark, the stocks are about the same. In France, much lower than they were in 1976. In Ireland they have gone down. In Italy, they have gone up, but again they have a mandate for the maintenance of stocks and inventory in private hands.

If we would look at major countries, like West Germany, the stocks have gone up remarkably. In the United Kingdom, stocks have gone down very markedly.

We can look at other countries, such as Spain, where they have gone up, and Portugal, where they've gone up. Norway, where they have gone up. The Netherlands, where they are about the same. Luxenbourg, where they have gone up by about 40 percent.

I would like to make some comparisons of what other countries are doing and how they are doing it so that we can look at what we are doing in terms of our own stock maintenance and the Government policy that produced it.

Mr. VAUGHAN. Mr. Chairman, we will try to provide that information and we will try to work with Department of State in providing a report to this committee on stocking policy and levels.

One thing I would point out, sir, is that as one looks at national stocks, one needs to think in terms of what the projected demands are.

The CHAIRMAN. Yes, and I was going to ask that you include what it means in forward days of consumption.

Mr. VAUGHAN. I think we find the world situation, certainly the free world, currently is in a fairly healthy stock position, even though the total numbers are down but these were at higher levels of activity, back before conservation had taken effect, et cetera.

We will provide that information, Mr. Chairman.

[The information follows:]

IEA Member Government Policies to Encourage Stocking

Australia:	Government does not mandate that industry hold compulsory stocks; provides tax relief for construction of some storage facilities.
Austria:	Government mandates that industry hold 90 days of imports in inventory; provides tax relief to offset a portion of costs of compulsory stock commitment.
Belgium:	Government mandates that industry hold 90 days of imports in inventory.
Canada:	Government does not mandate that industry hold compulsory stocks.
Denmark:	Government mandates that industry hold 90 days of imports in inventory; Public Corporation, FDO, holds additional product inventories, financed via Government loan guarantees.
Germany:	Government mandates that industry hold 25 days of imports; Public Corporation, EBV, holds 65 days; Government SPR holds additional 25 days.
Greece:	Government mandates that industry hold 90 days of imports. (State Oil Company dominates oil market.)
Ireland:	Government mandates that industry and large consumers hold 90 days of imports.
Italy:	Government mandates that industry hold 90 days of imports. State company, ENI, largest company in domestic oil market, holds 10 day Government-financed SPR.
Japan:	Government mandates that industry hold 90 days of imports; State Corporation, JNOC, holds Government SPR (70 million barrels, 18 days); Government provides financial incentives for construction of private industry storage; JNOC participates in joint storage projects with industry.
Luxembourg:	Government mandates that industry hold 90 days of imports.
Netherlands:	Government mandates that industry hold 90 days of imports; Public Corporation, ICOVA, holds additional, segregated stocks (11 million barrels, 22 days).

New Zealand: Government does not mandate that industry hold compulsory stocks; Government SPR holds 2 million barrels or 25 days.

Norway: Government does not mandate that industry hold compulsory stocks; Government provides subsidies for some companies' agricultural fuel stocks for use in wartime.

Portugal: Government mandates that industry hold 120 days of imports. (State Company, Petrogal, dominates domestic oil industry.)

Spain: Government mandates that industry hold 90 days of imports; State Oil Company, Hispanoil, dominates domestic oil market; stock holding by State Marketing Monopoly, CAMPSA, financed by Government.

Sweden: Government mandates that industry hold 110 days of the previous year's consumption in inventory; Government provides interest free grants and favorable depreciation allowances for investment in compulsory inventory level and storage facilities; Government maintains SPR (level is classified).

Switzerland: Government mandates that industry hold 100 days of imports; Government provides low interest, guaranteed loans to cover 90% of compulsory stockholding cost and tax breaks for construction, financing and maintenance expenditures for storage facilities.

UK: Government mandates that industry hold 76.5 days of consumption.

Office of International Affairs
November 18 1983

IEA Inventories

At present, IEA stocks total 3 billion barrels, representing 94 days of forward consumption, or 173 days of 1982 net oil imports. These inventories are distributed as follows:

Inventories

October 1, 1983

	MMBBL	Days of Forward Consumption	Days of 1982 Net Oil Import 1/
Australia	38	67	209
Austria	25	105	132
Belgium	33	66	81
Canada	102	77	3502
Denmark	37	143	197
Germany	281	127	128
Greece	27	104	115
Ireland	9	98	99
Italy	170	91	99
Japan	432	94	100
Luxembourg	2	81	82
Netherlands	72	96	242
New Zealand	7	86	100
Norway	17	88	--
Portugal	15	74	60
Spain	86	101	81
Sweden	51	100	121
Switzerland	47	161	186
Turkey	16	43	50
UK	120	66	--
U.S.	1415	94	318

1/ Reflects stock levels and previous calendar year net imports, calculated using adjustments and exclusions specified in the IEA Emergency Reserve definitions.

The CHAIRMAN. Secretary Wendt, I understand, and I accept the explanation that the AST-4 test was a procedural test, not necessarily one that reflects current policy. But it has certainly had the effect of focusing on what our policy should be as revealed by the results of that test.

I am told that a number, if not most, U.S. oil companies participating in that test said they would not volunteer to make oil available internationally in a real shortage without a domestic fair-sharing program. Am I correct in that?

Mr. WENDT. Mr. Chairman, according to our information, a significant number, perhaps a majority, of the companies have indicated that in order for them to be able to participate in the IEA emergency sharing scheme without suffering disproportionately relative to other companies, there needed to be some provision to avoid putting them at a serious disadvantage.

As I think both Mr. Vaughan and I have indicated in our testimony, we are aware of that problem. We have noted that drawdown of the SPR is one means to encourage companies to participate voluntarily in the system and that there also is the possibility of implementing a system of directed supply orders to the various companies to insure that the burden is shared equally.

If it were to appear that other means were necessary, we are prepared to consider that situation. I think that is exactly what Mr. Vaughan said in his testimony and there is complete agreement between us on that point.

The CHAIRMAN. What was the reaction of participants in AST-4 at the State level with respect to the invocation by the States of the authority that they have under State law, or might have under State law, with respect to the allocation or preservation of supplies?

Mr. VAUGHAN. There was a variety of response on the part of States, Senator. It is interesting. Let me point out that through our efforts all of our States monitored the ongoings of AST-4 through the electronic mail systems.

Ten of the States actually were funded by us to involve their energy response systems and we tried to select them on a cross-sectional basis to have many types and regions represented with different types of problems. They actually played the test actively in message traffic with us.

Interestingly, no State imposed price and allocation controls per se during the test. A number of them did impose, and we can give you the details on this, odd and even days for gasoline purchase and that sort of thing.

[The information follows:]

The simulated actions taken by the participating States during AST-4 were:

(1) Active public information program (10 States).

(2) 55 mph speed limit enforcement (10 States).

(3) Imposition of minimum purchase requirements (2 States).

(4) Odd-even gasoline days (3 States).

(5) State government buildings conservation measures (5 States).

(6) State personnel travel restrictions (6 States).

(8) Encouraged ridesharing, public transportation use, and retail station flag system (9 States).

The CHAIRMAN. I am told that the State of California invoked, activated its price and allocation program, and at least one other State started to do so before the test concluded.

Is that information incorrect?

Mr. VAUGHAN. Let me verify that, sir. I believe that California did not impose fully price and allocation controls in the test.

The CHAIRMAN. If that is true, I wish you would tell GAO.

Mr. VAUGHAN. I will be certainly glad to provide the message traffic.

[The information follows:]

As California's AST-4 message of June 7, 1983, indicates, at the time California declared a state of emergency it implemented the following three programs (none of which were price and allocation controls):

1. Imposed a severance tax to augment financial support for existing Federal and state low-income assistance programs;

2. Activated the emergency gasoline and diesel state set-aside program; and

3 Established a law enforcement mutual aide program throughout the state to maintain public order and safety.

A review of all California AST-4 message traffic (copies attached) reveals that only Federal imposition of price and allocation controls is mentioned. For example, California consulted with all PADD V states (May 1, 1983, Report sent on April 28, three days before the AST-4 test officially started) that Federal assistance would be expected to control price or distribute block grants for economic hardship.

To: N.WENTZEL-ME (DOE413)
To: J.EDWARDS-NY (DOE417)
To: N.GILL-WY (DOE434)
To: M.MASSEY-WI (DOE447)
To: W.BALL-MS (DOE467)
To: D.WALKER-FL (DOE470)
To: R.DUMAS-VT (DOE483)
To: J.GOODING-TX (DOE485)
To: L.GOLTZ-KA (DOE500)
Cc: Y.ALLENA (DOE400)
From: T.RAUH-CA (DOE468) Posted: Thu 28-Apr-83 18:43 Sys 63 (156)
To: A.GANDARA-CA (DOE468)
Subject: california emergency action - first quarter 1981

this message is for purposes of the ast4 test only and has no relationship to events in the real world.

MAY 1, 1981

in response to the world oil supply disruptions which began in DECEMBER of 1980 the california energy commission activated the verification phase of california's energy emergency response. during the month of JANUARY the chairperson of the commission directed staff to determine the state's existing energy situation. commission staff contacted energy suppliers and the federal government to obtain data and intelligence concerning the impending shortage. staff found no immediate impacts to the state of california, but noted that the shortfall to the u.s. as a whole could be as high as 10%. staff indicated that if the shortage persisted or became worse, a strong likelihood existed that indonesian and alaskan oil could be redirected away from california as a result of national iea commitments or changing market conditions. staff also noted that such redirections could lead to a substantial increase in oil prices.

in a FEBRUARY meeting with the governor the chairperson recommended that the pre-emergency phase of california's energy emergency response be activated. on the basis of this recommendation, and information received from california's major oil companies that caliornia oil supplies are being redirected to meet company contract committments nationwide, the governor activated the pre-emergency phase on MARCH 1, 1981. in conjunction with this action the governor delivered a televised address. his statement contained the following elements:

- a general appeal for the public to reduce its gasoline use in order to hold down gasoline prices;
- a request that county governments voluntarily implement the emergency ridesharing, transit and public information components of their gasoline emergency plans;
- an appeal for businesses and industries to voluntarily implement emergency energy conservation programs, draw down fuel inventories, and where possible, switch from oil to natural gas;
- issuance of an executive order requiring specific energy use reductions in state government operations;
- establishment of an energy emergency center (at the california energy commission) to collect and coordinate the flow of data and information during the emergency period; and
- establishment of an energy suppliers advisory committee and an energy consumers advisory committee for the purpose of receiving assistance from the private sector in interpreting the emergency condition.

in response to the governor's televised statement, county governments associated with california's major metropolitan areas implemented their gasoline emergency plans. all of these plans were in place by APRIL 1, 1981.

DURING THE MONTH OF APRIL gasoline prices in california increased from an average of $1.44 per gallon to $2.19 per gallon. diesel fuel prices increased from an average of $1.24 per gallon to $1.95 per gallon. these rapid price increases created substantial problems for the state of california:

- the tourist industry complained that government inaction had all but eliminated pleasure travel in the states of california and nevada;

- farmers announced that high fuel prices would be passed on to consumers by july. (the april price shock occurred at a critical period in california's planting and harvesting cycle. completion of seasonal harvests of avocados, sugar beets, citrus fruits and grains have been threatened, and some farmers have switched away from seasonal plantings of rice, cotton and beans for less energy-intensive crops.)

- representatives of low-income groups intensively lobbied california's elected officials for the establishment of a special state fund to help the poor in coping with the emergency condition. to obtain revenue for this fund, a bill is rapidly moving through the california legislature to establish a 5% severence tax on oil production within the state.

- local governments reported forced reductions in government services due to the high cost of fuel. the demand for local welfare services has increased substantially. transit services have already reached capacity.

- sporadic incidents of violence at retail gasoline outlets have been reported. incidents are stemming from objections to "unfair" pricing.

preliminary analyses have been completed on the impacts of increased gasoline price on california's gasoline demand. while the national average for gasoline price elasticity appears to be -.15, california's specific elasticity is approximately -.10. while no numbers have been received concerning the state diesel price elasticity, it is much lower than the national average which was indicated at -.15. the insensitivity of california's diesel demand to increasing price is primarily attributable to the heavy agricultural and trucking activity now occurring within the state.

preliminary estimates of economic impacts have also been completed. economic analyses indicate an expected 5% decrease in the gross state product for california during 1981. this decrease will be accompanied by a 4% reduction in employment (10.7 million to 10.3 million), increasing the state unemployment rate from 6.5% to 9.0%.

california is currently performing an analysis of price shock impacts on fuel switching from oil to natural gas. the results of this analysis will be made available when it is completed.

0278

DURING THE PAST WEEK the governor of california has been in touch with governors in other padd v states. it was learned that these states have taken similar demand reduction steps during the month of april. a majority of padd v states have encouraged their congressional delegations to take action to halt the rapid increase in petroleum prices, and provide federal assistance to states for the purpose of relieving economic hardships caused by the april price shock. if the price of petroleum products continues to increase during may, padd v states are in agreement that they will EXPECT federal assistance in either controlling price or distributing block grants. at least one state has stated that it will actively lobby for reinstatement of price and allocation controls in order to be assured of receiving their fair share of oil supplies.

during the past few days the governor of california has been in daily contact with the california congressional delegation. the governor has emphasized to the delegation the need for a drawdown of the spr in order to control any additional oil price increases. the governor has also stressed the need for economic relief at the federal level in the form of block grants to states for the purpose of assisting the non-working poor. the governor made a personal appeal for federal action in a 45 minute telephone conversation with the president on april 30, 1981.

NOTE: please forward this message to all padd v states, california local governments (doe511) and the national governors association.

commissioner arturo gandara
presiding member, fuels planning committee.
california energy commission

Comments from: A.GANDARA-CA (DOE468) Posted: Sun 8-May-83 10:14 Sys 63

california transmitted this message to doe on april 28, 1983. based on your telephone calls and "message" inquiries, this first california message was never retransmitted by doe. it is being provided directly to you at this time so that you may have a better understanding of california's initial interpretation of the ast4 scenario and our "simulated" emergency response.

Disposition: file
Filed

Disposition: file pending
Filed in category PENDING

Disposition: d

read

0335

To: Y.ALLENA (DOE400)
From: A.GANDARA-CA (DOE468) Posted: Thu 12-May-83 13:47 Sys 64 (7)
Subject: status of california inquiries - package 1

on sunday, may 8, california transmitted to doe a series of questions concerning cycle 1 of the ast4 simulation. many of these questions required only a "yes or "no" answer. we would appreciate a response to our questions by may 13. if this response is not forthcoming by the end of this week, please indicate the earliest date on which we can expect a doe reply.

read

#355

To: Y.ALLENA (DOE400)
From: A.GANDARA-CA (DOE468) Posted: Fri 13-May-83 23:25 Sys 64 (53)
Subject: response to doe request concerning federal public info activities

RECEIVED
1983 MAY 16 AM 8:39

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relationship to events in the real world.
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a press release should be distributed from the white house subsequent to each change in the emergency condition that could potentially lead to a misinterpretation of the situation. the president should hold a news conference in conjunction with each major decision to activate or NOT activate an emergency program.

all relevant information concerning the national emergency condition should emanate from the white house, presumably through the secretary of energy. state and local governments are better sources of information concerning state and local emergency conditions.

in relation to ast4, questions from the public which california is least prepared to answer include the following:

> "when are prices going back down?"
>
> "why isn't the federal government doing anything?"
>
> "what about all those tankers waiting just off the coast for the price to go up?"
>
> ? "why is the strategic petroleum reserve still being filled?" force majeure?
>
> "why hasn't the rapid deployment force been used to reopen the straits of hormuz?"

information concerning international events related to the emergency should be released by the federal government. the federal government should also, on a regular basis, release some type of short-term projection on the expected behavior of petroleum product prices. this information is not just for the benefit of the general public, but also for the business community which is trying to maintain some type of advanced planning in the midst of the emergency.

the clearinghouse appears to be a good idea in relation to ast4, but in the real world it might become an administrative nightmare. if such a clearinghouse is established, it should be done for the states and should operate through the dialcom system.

to date, federal public issuances on the crisis have been insufficient, particularly since the first indication of presidential action was the nga meeting on may 9. based on information provided in relation to cycle 1, the federal government has done nothing between december, 1980, and may, 1981, to inform the public of the developing emergency and its EXPECTED impacts on price.
d

To: Y.ALLENA (DOE400)
From: A.GANDARA-CA (DOE468) Posted Mon 16-May-83 21 52 Sys 64 (101)
Subject: status report on california's emergency condition

#0377

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this message is for the purposes of the ast4 test only and has no relationship to events in the real world.

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MAY 16 1983

the governor returned "empty-handed" from washington d.c. to find the emergency condition within his state becoming more severe. while the governor was negotiating with the president and other governors last tuesday a spokesperson for california's independent trucking association announced from san francisco that his group would hold a rally at the state capitol to protest the state's lack of action in controling the rapidly increasing price of diesel fuel. independent truckers in california represent one-half of california's total trucking fleet.

in addition to problems with increasing diesel prices, the california energy emergency center learned last wednesday that spot shortages of diesel fuel were beginning to occur throughout the state. analyses performed by emergency center staff indicate that this problem in diesel availability is due to a continuing high demand for diesel fuel despite a 100% increase in price. this problem which was first identified in california's may 1 status report, is being caused by the fact that at least 33% of caliornia's diesel fuel demand (agriculture trucking and transit operations) has been unaffected by the april price increase. this low insensitivity to price has been confirmed in statements by farmers and truckers who have announced their intention to pass additional fuel costs along to consumers. these same groups however continue to be very concerned about the impact of higher prices on the future demand for their products.

until diesel prices increase further to compensate for this ongoing demand, spot shortage are expected to continue. as indicated in table 1 the difference between doe's projected demand restraint for diesel and actual demand restraint (at least in california) is approximately 8%.

TABLE 1

1981 CALIFORNIA DISTILLATE CONSUMPTION

	may	june	july
actual consumption (mbd)	188.2	190.7	188.2
doe - ast4 consumption (mbd)	154.3	152.6	148.7
cec - ast4 consumption (mbd)	165.6	165.3	161.8
difference (mbd)	-11.3	-12.7	-13.1
doe/cec ratio	.93	.92	.92
presumed california shortfall (%)	-7	-8	-8

another factor contributing to caliornia's diesel problem is the lack of flexibility to increase diesel production in california's refineries. distillate production as a percent of crude input at california refineries typically ranges between 11.2% and 14.6%. during may, 1981 distillate production as a percent of crude input was 13.6%.

as a result of california's continuing high diesel demand emergency center staff projected a "new" average california distillate price for may june and july. based on an observed price elasticity of -0.1 table 2 indicates the diesel prices necessary to achieve the demand restraint presumed by doe.

TABLE 2

CEC-PROJECTED PRICE FOR DISTILLATE

	may	june	july
doe-projected demand restraint	18%	20%	21%
california base price	$1.25	$1.25	$1.25
doe-projected price (-0.15 elasticity)	$2.70	$2.75	$2.76
cec-projected price (-0.10 elasticity)	$3.50	$3.75	$3.88

on friday afternoon. may 13 the cec chairperson presented these findings to the governor and his cabinet in a formal briefing. as a result of the presentation, the governor instructed the california department of food and agriculture to determine the impact of these higher prices on caliornia food products. the food and ag report is due wednesday may 18.

staff at the energy emergency center is continuing to investigate the impact of these higher diesel prices on california's distillate exports.

of friday, may 13 the projected increase in the demand for state unemployment insurance funds has proven accurate.

```
     To:  T.RAUH-CA  (DOE468)
Subject:  0029 - iea disruption telex

--More--

                                                               #0074
his message is for purposes of the ast4 test only and has no relationship
o events in the real world.

in order for california to assess its emergency actions prior to
may 1, 1981, some indication of oil price behavior for the period
of december, 1980 through april, 1981 is required.  any of the
following information which can be provided for this period would
be appreciated:

   .  weighted average international price of crude oil by month
   .  price of indonesian crude oil minas 34 api by month
   .   new york spot market product prices for gasoline, heating oil
       and residual fuel oil by month


if this information cannot be provided in the next three hours  please
let me know.

i suggest that you provide similar information to other test participants.

b. b. blevins
--More--

lifornia energy commission

Comments from:  T.RAUH-CA  (DOE468) Posted:  Wed  27-Apr-83  11:18  Sys 63

repeat transmission of yesterday's request

Reply Requested.
Text:
.load ast-4-heading
10 lines loaded.

   the u.s. neso is awaiting clearance from the u.s. secretary of energy
   to transmit information on impact of the telex disruption.  meeting
   scheduled for this afternoon.  transmission will not occur until
   late afternoon  4-27-83  or early morning 4-28-83  edt.

                                             rlwinkler
                                             das/ee

cc
.cc r.winkler
.cc dob#00n
.ar
.ex

  AUH-CA  --  Sent Express
Y.ALLENA  --  Sent Express
Express letter call from Y.ALLENA  (DOE400)

R.WINKLER  --  Sent Express

Disposition:
```

To: Y.ALLENA (DOE48F)
From: T.RAUH-CA (DOE468) Posted: Thu 28-Apr-83 10:43 Sys 13 (146)
Subject: california emergency action - first quarter 1981

--more--

#0118

RECEIVED
1983 APR 28 AM 8 50

this message is for purposes of the est/test only and has no relationship to events in the real world.

MAY 1, 1981

in response to the world oil supply disruptions which began in DECEMBER of 1980 the california energy commission activated the verification phase of california's energy emergency response. during the month of JANUARY the chairperson of the commission directed staff to determine the state's existing energy situation. commission staff contacted energy suppliers and the federal government to obtain data and intelligence concerning the impending shortage. staff found no immediate impacts to the state of california, but noted that the shortfall to the u.s. as a whole could be as high as 3%. staff indicated that if the shortage persisted or became worse, a strong likelihood existed that indonesian and alaskan oil could be redirected away from california as a result of national iea commitments or changing market conditions. staff also noted that such redirections could lead to a substantial increase in oil prices.

in a FEBRUARY meeting with the governor the chairperson recommended that the pre-emergency phase of california's energy emergency response be activated. on the basis of this recommendation, and information

--more--

received from california's major oil companies that california oil supplies are being redirected to meet company contract committments nationwide, the governor activated the pre-emergency phase on MARCH 1, 1981. in conjunction with this action the governor delivered a televised address. his statement contained the following elements:

pre-Emergency plans

- a general appeal for the public to reduce its gasoline use in order to hold down gasoline prices;
- a request that county governments voluntarily implement the emergency ridesharing, transit and public information components of their gasoline emergency plans;
- an appeal for businesses and industries to voluntarily implement emergency energy conservation programs, draw down fuel inventories, and where possible, switch from oil to natural gas;
- issuance of an executive order requiring specific energy use reductions in state government operations;
- establishment of an energy emergency center (at the california energy commission) to collect and coordinate the flow of

--More--

Date

data and information during the emergency period; and

- establishment of an energy suppliers advisory committee and an energy consumers advisory committee for the purpose of receiving assistance from the private sector in interpreting the emergency condition.

in response to the governor's televised statement, county governments associated with california's major metropolitan areas implemented their gasoline emergency plans. all of these plans were in place by APRIL 1, 1981.

#0118

DURING THE MONTH OF APRIL gasoline prices in california increased from an average of $1.44 per gallon to $2.19 per gallon. diesel fuel prices increased from an average of $1.24 per gallon to $1.95 per gallon. these rapid price increases created substantial problems for the state of california:

gas. line price

- the tourist industry complained that government inaction had all but eliminated pleasure travel in the states of california and nevada;

--More--

- farmers announced that high fuel prices would be passed on to consumers by july. (the april price shock occurred at a critical period in california's planting and harvesting cycle. completion of seasonal harvests of avocados, sugar beets, citrus fruits and grains have been threatened, and some farmers have switched away from seasonal plantings of rice, cotton and beans for less energy-intensive crops.)

agriculture price

- representatives of low-income groups intensively lobbied california's elected officials for the establishment of a special state fund to help the poor in coping with the emergency condition. to obtain revenue for this fund, a bill is rapidly moving through the california legislature to establish a 5% severence tax on oil production within the state.

Revenue Recycl

- local governments reported forced reductions in government services due to the high cost of fuel. the demand for local welfare services has increased substantially. transit services have already reached capacity.

Local gov. serv.

- sporadic incidents of violence at retail gasoline outlets have been reported. incidents are stemming from objections

--More--

to "unfair" pricing.

preliminary analyses have been completed on the impacts of increased gasoline price on california's gasoline demand. while the national average for gasoline price elasticity appears to be -.15, california's specific elasticity is approximately -.38. while no numbers have been received concerning the state diesel price elasticity, it is much lower than the national average which was indicated at -.15. the insensitivity of california's diesel demand to increasing price is primarily attributable to the heavy agricultural and trucking activity now occurring within the state.

0118

preliminary estimates of economic impacts have also been completed. economic analyses indicate an expected 5% decrease in the gross state product for california during 1981. this decrease will be accompanied by a reduction in employment (10.7 million to 10.3 million), increasing the state unemployment rate from 6.5% to 9.0%.

california is currently performing an analysis of price shock impacts on fuel switching from oil to natural gas. the results of this analysis will be made available when it is completed.

fuel switching

--More--

DURING THE PAST WEEK the governor of california has been in touch with governors in other padd v states. it was learned that these states have taken similar demand reduction steps during the month of april. a majority of padd v states have encouraged their congressional delegations to take action to halt the rapid increase in petroleum prices, and provide federal assistance to states for the purpose of relieving economic hardships caused by the april price shock. if the price of petroleum products continues to increase during may, padd v states are in agreement that they will EXPECT federal assistance in either controlling price or distributing block grants. at least one state has stated that it will actively lobby for reinstatement of price and allocation controls in order to be assured of receiving their fair share of oil supplies.

allocation pricing controls

during the past few days the governor of california has been in daily contact with the california congressional delegation. the governor has emphasized to the delegation the need for a drawdown of the spr in order to control any additional oil price increases. the governor has also stressed the need for economic relief at the federal level in the form of block grants to states for the purpose of assisting the non-working poor. the governor made a personal appeal for federal action in a 15 minute telephone conversation with the president on april 30, 1981.

SPR Drawdown

--More--

NOTE: please forward this message to all padd v states, california local governments (doe811) and the national governors association.

commissioner arturo gandara
presiding member, fuels planning committee
california energy commission

Disposition: quit

Fd: Y.ALLENC (DOE416)
FROM: Y.ALLENA (DOE400) POSTED: FRI 29-APR-83 16:00 SYS 63 (108)
TO: R.WINKLER (DOE503)
S CT: AST-4 LOCAL GOVERNMENT ACTIONS (DOE#0129)
A WLEDGEMENT SENT

#0118A

AST-4 TEST MESSAGE

THIS MESSAGE IS FOR PURPOSES OF THE AST-4 TEST ONLY AND HAS NO RELATIONSHIP TO EVENTS IN THE REAL WORLD.

AST-4 TEST MESSAGE

THIS MESSAGE IS FOR PURPOSES OF THE AST-4 TEST ONLY AND HAS NO RELATIONSHIP TO EVENTS IN THE REAL WORLD.

IN ACCORDANCE WITH APPROVED LOCAL GOVERNMENT FUEL SHORTAGE PLANS, THE CALIFORNIA GOVERNMENT CODE AND AT THE REQUEST OF THE GOVERNOR OF CALIFORNIA, LOCAL GOVERNMENT HAS IMPLEMENTED THE FOLLOWING ACTIONS:

) CONVENED PUBLIC/PRIVATE SECTOR FUEL SHORTAGE MANAGEMENT COUNCILS. THESE COUNCILS WILL HELP TO ASSESS THE ACTUAL IMPACT OF THE SHORTAGE IN THE LOCAL REGION;

2) APPOINTED COORDINATORS AT THE COUNTY LEVEL;

3) ESTABLISHED INFORMATION HOTLINES;

4) REQUIRED ALL SERVICE STATIONS TO USE COLORED FLAGS INDICATION FUEL AVAILABILITY;

5) ESTABLISHED MINIMUM PURCHASE REQUIREMENTS AT ALL SERVICE STATIONS;

6) ESTABLISHED MAXIMUM PURCHASE REQUIREMENTS FOR SEPARATE CONTAINERS AT SERVICE STATIONS;

7) THE PUBLIC HAS BEEN ENCOURAGED BY BOTH GOVERNMENT AND PRIVATE SECTOR REPRESENTATIVES TO CARPOOLS AND VANPOOL;

8) INDUSTRY HAS BEEN ENCOURAGED TO SWITCH FROM OIL TO ALTERNATIVE FUELS;

TRANSIT AUTHORITIES, IN COOPERATION WITH MAJOR EMPLOYERS, ARE ESTABLISHING:
A. PARK AND RIDE LOTS,
B. RIDESHARING COORDINATION CENTERS AT MAJOR EMPLOYMENT LOCATE LOCATIONS.

10) TRANSIT AUTHORITIES AND DEPARTMENTS OF EDUCATION ARE MEETING TO DISCUSS THE POSSIBLE USE OF SCHOOL BUSES. THESE BUSES WILL BE USED TO TRANSPORT EMPLOYEES TO AND FROM MAJOR WORK CENTERS AND WILL NOT BE USED TO AUGMENT EXISTING ROUTES;

COUNTIES ARE REVIEWING POSSIBLE REVENUE RECYCLING ALTERNATIVES AND OTHER SOCIAL SERVICE NEEDS AT THE LOCAL LEVEL;

12) CITIES AND COUNTIES ARE COMPLETING INVENTORY OF FUEL SUPPLIES.

0118A

COMMENTS:

A. IN ORDER TO MINIMIZE THE "TOPPING-OFF" OF STORAGE FACILITIES WITH A CAPACITY IN EXCESS OF 5,000 OR 10,000 GALLONS, IT HAS BEEN SUGGESTED THAT A "FLOOR TAX" BE SET ON ALL FUEL HELD IN EXCESS OF THE AVERAGE AMOUNT STORED OVER THE LAST THREE MONTHS.

B. WE ARE FINDING THAT SERVICE STATION OWNERS, IN ORDER TO KEEP THE AMOUNT OF MONEY THEY HAVE TIED UP IN INVENTORY TO A MINIMUM, HAVE BEEN KEEPING THEIR BELOW STORAGE TANKS AT ONE-THIRD OF THEIR FULL LEVEL (NORMAL IS ONE-HALF).

THUS, AS THE RUN ON SERVICE STATIONS CONTINUES TO INCREASE THEIR LOWER STORAGE LEVELS PLUS THE PUBLIC ABILITY TO DRAW THE FUEL DOWN THE FUEL FASTER THAN IT CAN BE DELIVERD, , THE INCIDENCE OF SERVICE STATIONS CLOSING EARLY IS ALSO INCREASING.

C. PLEASE KEEP US ADVISED OF AT STATE'S INTENTIONS REGARDING STATE SET-ASIDE AND REVENUE RECYCLING AS WE ARE STARTING TO HAVE PROBLEMS WITH FUEL AND A RUN ON OUR SOCIAL SERVICES PROGRAMS HAS BEGUN.

NOTE: PLEASE FORWARD THIS MESSAGE TO THE STATE OF CALIFORNIA (DOE468) AND TO THE NATIONAL ASSOCIATION OF COUNTIES (DOE553).

Cc: R.WINKLER (DOE503)
From: ,Y.ALLEND (DOE494) Posted: Fri 29-Apr-83 15:38 Sys 63 (49)
To: R.WINKLER (DOE503)
Subject: Analysis of California Situation (DOE#0124) # 0124

RECEIVED

1983 MAY 2 TEST MESSAGE

THIS MESSAGE IS FOR PURPOSES OF THE AST-4 TEST ONLY AND HAS NO RELATIONSHIP TO EVENTS IN THE REAL WORLD.

T. RAUH-CA (DOE468)

R. WINKLER

SUBJECT:ANALYSIS OF CALIFORNIA SITUATION

THANK YOU FOR COMPREHENSIVE REVIEW OF ACTIONS AND EVENTS TO DATE IN CALIFORNIA. (1) PLEASE ADVISE ON CURRENT STATUS AND PROJECTIONS FOR CALIFORNIA STATE UNEMPLOYMENT FUNDING. DO YOU ANTICIPATE CONTINUING ABILITY TO MEET UNEMPLOYMENT FUND OBLIGATIONS WITHOUT FEDERAL ASSISTANCE? ~~(2) PLEASE ADVISE ON PLANS FOR DISSEMINATION OF FUNDS WITHIN CALIFORNIA IN THE EVENT FEDERAL BLOCK GRANTS SHOULD BECOME AVAILABLE. PLEASE PROVIDE ORDER-OF-MAGNITUDE ESTIMATES OF FUTURE FUNDING NEEDS (REGARDLESS OF SOURCE) F ASSISTANCE TO NON-WORKING POOR.~~ 1 2 PLEASE PROVIDE ESTIMATES O REVENUES EXPECTED FROM PROPOSED STATE SEVERANCE TAX ON IN-STATE OIL PRODUCTION. 3 PLEASE PROVIDE TO D.O.E. FOR INFORMATION, A SUMMARY OF GASOLINE EMERGENCY ACTIONS BEING IMPLEMENTED UNDER METROPOLITAN-AREA COUNTY PLANS. 4 PLEASE PROVIDE SUMMARY OF REDUCTIONS IN LOCAL GOVERNMENT SERVICES AND YOUR PROJECTIONS FOR NEAR-TERM, BASED ON CURRENTLY AVAILABLE INFORMATION. YOUR MESSAGE DATED 28 APRIL, 1983 (POSTED 18:43) HAS BEEN RETRANSMITTED AS YOU REQUESTED.

#0129

To: Y.ALLENA (DOE488)
From: P.RAVER-CA (DOE511) Posted: Fri 29-Apr-83 11:51 Sys 10 (86)
Subject: AST 4 TEST-LOCAL GOVERNMENT ACTIONS

AST-4 TEST MESSAGE

THIS MESSAGE IS FOR PURPOSES OF THE AST-4 TEST ONLY AND HAS NO RELATIONSHIP TO EVENTS IN THE REAL WORLD.

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2) APPOINTED COORDINATORS AT THE COUNTY LEVEL;

3) ESTABLISHED INFORMATION HOTLINES;

4) REQUIRED ALL SERVICE STATIONS TO USE COLORED FLAGS INDICATION FUEL AVAILABILITY;

5) ESTABLISHED MINIMUM PURCHASE REQUIREMENTS AT ALL SERVICE STATIONS;

6) ESTABLISHED MAXIMUM PURCHASE REQUIREMENTS FOR SEPARATE CONTAINERS AT SERVICE STATIONS;

7) THE PUBLIC HAS BEEN ENCOURAGED BY BOTH GOVERNMENT AND PRIVATE SECTOR REPRESENTATIVES TO CARPOOLS AND VANPOOL;

8) INDUSTRY HAS BEEN ENCOURAGED TO SWITCH FROM OIL TO ALTERNATIVE FUELS;

9) TRANSIT AUTHORITIES, IN COOPERATION WITH MAJOR EMPLOYERS, ARE ESTABLISHING:
   A. PARK AND RIDE LOTS,
   B. RIDESHARING COORDINATION CENTERS AT MAJOR EMPLOYMENT LOCATE LOCATIONS.

10) TRANSIT AUTHORITIES AND DEPARTMENTS OF EDUCATION ARE MEETING TO DISCUSS THE POSSIBLE USE OF SCHOOL BUSES. THESE BUSES WILL BE USED TO TRANSPORT EMPLOYEES TO AND FROM MAJOR WORK CENTERS AND WILL NOT BE USED TO AUGMENT EXISTING ROUTES;

11) COUNTIES ARE REVIEWING POSSIBLE REVENUE RECYCLING ALTERNATIVES AND OTHER SOCIAL SERVICE NEEDS AT THE LOCAL LEVEL;

12) CITIES AND COUNTIES ARE COMPLETING INVENTORY OF FUEL SUPPLIES.

A. 'IN ORDER TO MINIMIZE THE "TOPPING-OFF" OF STORAGE FACILITIES WITH A CAPACITY IN EXCESS OF 5,000 OR 10,000 GALLONS, IT HAS BEEN SUGGESTED THAT A "FLOOR TAX" BE SET ON ALL FUEL HELD IN EXCESS OF THE AVERAGE AMOUNT STORED OVER THE LAST THREE MONTHS.

0129

B. WE ARE FINDING THAT SERVICE STATION OWNERS, IN ORDER TO KEEP THE AMOUNT OF MONEY THEY HAVE TIED UP IN INVENTORY TO A MINIMUM, HAVE BEEN KEEPING THEIR BELOW STORAGE TANKS AT ONE-THIRD OF THEIR FULL LEVEL (NORMAL IS ONE-HALF).

THUS, AS THE RUN ON SERVICE STATIONS CONTINUES TO INCREASE THEIR LOWER STORAGE LEVELS PLUS THE PUBLIC ABILITY TO DRAW THE FUEL DOWN THE FUEL FASTER THAN IT CAN BE DELIVERD, , THE INCIDENCE OF SERVICE STATIONS CLOSING EARLY IS ALSO INCREASING.

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NOTE* PLEASE FORWARD THIS MESSAGE TO THE STATE OF CALIFORNIA (DOE468) AND TO THE NATIONAL ASSOCIATION OF COUNTIES (DOE553).

Fw: J.BROWN (DOE402)
From: T.RAUH-CA (DOE468) Posted: Tue 3-May-83 17 15 Sys 63 (26)
To Y.ALLENA (DOE400)
Subject: May 9 meeting with the president

Incoming
0193

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***************************************************************************
this messaage is for the purposes of the ast4 test only and has no
relationship to events in the real world.
***************************************************************************
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california will be represented at the may meeting with the president. california would like to see the following items included as part of the meeting's agenda:

- intention of the federal government to use the spr
- disposition of revenues collected by the federal government in the event that the spr is used and
- disposition of additional windfall profits taxes being collected by the federal government during 1981.

for a status report concerning the emergency condition within california, please see message transmitted to doe on april 28, 1983.

commissioner arturo gandara
presiding member, fuels planning committee
california energy commission

Comments from: Y.ALLENA (DOE400) Posted: Tue 3-May-83 22:20 Sys 63

#0223

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     To: J.BROWN   (DOE402)
   From: A.GANDARA-CA  (DOE468) Posted: Wed  4-May-83  13:22  Sys 63  (65)
     To: Y.ALLENA  (DOE400)
Subject: request concerning california's shortages
```

****
this message is for the purposes of the ast4 test and has no relationship
to events in the real world.
****

the message to which you are reffering, which contains a list of 12 actions taken by california local governments, is in the state of california's not ast4 response. one of california's local governments, orange county, is tied into the dialcom system, and it is their message which refers to gasoline queue management controls. california's ast4 response was transmitted april 28, 1981 (doe#0124). Unfortunately, doe is transmitting and retransmitting the orange county message as the state message. many participants and non-participants in ast4 have been confused because they believe that the orange county message is in fact the california message. california informed doe of this problem at the end of last week and the beginning of this week, but for some reason doe has chosen ?? not to retransmit our message.

to answer your question, california's ast4 message (doe#0124) summarized emergency conditions and subsequent state government actions during quarter 1, 1981. the intent of this message was to bring california's emergency plan in line with the first date of the simulated disruption exercise (may 1, 1981). in this message california noted that the governor requested voluntary implementation of local gasoline emergency plans (march 1,1981) to help hold down gasoline prices. these plans contain emergency ridesharing and transit plans, as well as gasoline queue management options. in the initial stages of california's planned oil emerency response, local governments have the discretion of choosing emergency options from their plans they feel are necessary for mitigating local emergency conditions. when the california local government tied to dialcom (orange county) heard of california's ast4 message, it transmitted a list of actions that it would have taken in response to the governor's request. this is the message that contained references to gasoline queue management controls. when orange county was questioned about its presumed use of these controls, it responded that in discussions with gasoline retailers the retailers had insisted these controls were necessary for the prevention of panic purchases of gasoline as mototrists attempted to "stockpile" additional fuel in anticipation of rpidly increasing gasoline prices.

as of may 1, 1981, the state of california has not implemented gasoline queue management controls. the presumption of california is that increasing price has, for the most part, brought gasoline demand in balance with supply. however, in early march, some local governments may have imposed queue management controls to maintain order at gasoline retail outlets during the transitionn toward higher prices.

#0223

if you would like to receive a copy of california's ast4 message of april 28 (doe#0124), please contact your doe representative and request a copy. if doe does not respond to your request, please let me know via dialcom and i will forward a copy to you.

i hope that this message has cleared up some of doe's apparent confusion.

b. b. blevins
california energy commission

#0225

```
   From: A.GANDARA-CA  (DOE468) Posted:  Thu  5-May-83  11:10  Sys 63  (31)
Subject:  response to doe inquiry (doe#110) on emergency shool bus use

************************************************************************
this message is for the purposes of the ast4 test only and has no
relationship to events in the real world.
************************************************************************

the augmentation of transit services with school buses during an oil supply
emergency occurs in california at the discretion of local governments.
in urban areas of the state, local gasoline emergency plans contain
provisions for implementing this emergency action.  california is currently
surveying these urban areas to determine their intention to activate
emergency school bus utilization plans during may, 1981.

currently, there are approximately 10,000 public, private and contract
school buses within the state.  these buses account for 500 million
passenger trips per year, or about 50,000 passenger trips per bus.
if 20% of these buses are made available to augment existing transit
systems, the capacity to provide another 100 million passenger trips
during on-peak commute hours would be available.  assuming these buses
operated at 75% capacity, the additional passenger trips actually achieved
would be 75 million.  since the average distance traveled by a bus
passenger in california is 5 miles per trip, these additional 75 million
bus passenger miles represents an elimination of 375 million miles
traveled by individuals in single occupant autos.  using an average
california light-duty vehicle efficiency of 18 miles per gallon, the
deployment and use of 20% of the available school buses during an oil
emergency could save 21 million gallons of gasoline per year operating
at 75% capacity.  this amount represent 0.2% of california's annual
gasoline consumption.

  b. blevins
california energy commission

Disposition:



                  delete

End of Scanned Mail.

>off
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#0254

TO: DOE468 DOE511
SUBJECT: CLARIFICATION OF CALIFORNIA AND ORANGE COUNTY MESSAGES

THANK YOU FOR FURTHER CLARIFYING THE DISTINCTION BETWEEN MESSAGES TRANSMITTED BY THE STATE OF CALIFORNIA AND ORANGE COUNTY, CALIFORNIA. BECAUSE THIS IS A UNIQUE SITUATION IN WHICH A LOCAL JURISDICTION IS FUNCTIONING INDEPENDENTLY DURING THE SIMULATION, WE EXPECT AN OCCASIONAL SLIP-UP. INDEED, PART OF THE RATIONALE FOR HAVING ORANGE COUNTY ACTIVE ON THE DIALCOM NETWORK DURING AST-4 IS TO ASSESS THE FEASIBILITY OF EXPANDED COVERAGE DURING A REAL EMERGENCY. IT MIGHT BE HELPFUL IF THE STATE OF CALIFORNIA AND ORANGE COUNTY WORKED IN CLOSER COORDINATION DURING THIS TEST, AS THEY WOULD DURING A REAL CRISIS. ORANGE COUNTY SHOULD CONTINUE TO PERFORM AS AN INDEPENDENT PLAYER IN AST-4. TO INSURE AGAINST FUTURE CONFUSION, HOWEVER, IT MIGHT BE USEFUL IF ORANGE COUNTY NOTED IN FUTURE MESSAGES WHETHER THE SIMULATED ACTION OR OTHER MATTERS WERE COORDINATED WITH THE CALIFORNIA ENERGY COMMISSION. SUCH A NOTE WOULD MAKE CLEAR WHETHER ORANGE COUNTY WAS ACTING AS AN INDEPENDENT REPRESENTATIVE OF LOCAL GOVERNMENTS AROUND THE COUNTRY OR AS A POLITICAL SUBDIVISION OF THE STATE OF CALIFORNIA. DOE WILL TAKE MEASURES TO PRECLUDE REOCCURRENCE.

Subject: california emergency situation

eeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeeee
this message is for the purposes of the aet4 test only and has no
relationship to events in the real world.
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MAY 6,1981 Incoming #0266

adequate petroleum product supplies continue to be available in california. this availability is primarily due to prime suppliers and jobbers not substantially increasing their inventories since april 1, 1981. if, however, prices continue to increase during may, it is uncertain how long this reluctance to build inventories will continue

public pressures for government action to control fuel prices continue to persist. events reported by the press in the past week have added to these pressures:

- a survey completed by a group of southern california chambers of commerce indicates that 1/3 of all businesses are beginning employee layoffs.
- the state of nevada reported that counts of automobiles entering their state dropped by 15% during april, 1981.
- california's major oil companies reported a substantial increase in profits for the first quarter of 1981.

on the bright side, california's electric utilities and industries reported that they had responded to the governor's march 1 appeal. these groups indicated that by may 1 they had almost completely displaced their use of residual fuel oil with natural gas.

new projections of expected infreases in the price of oil were received from doe this week. these projections indicate that crude oil prices will increase to $98/barrel, $30/barrel over the actual reported price for april, 1981. on the basis of this projection, california has revised its unemployment estimates for 1981. california originally estimated that the unemployment rate for 1981 would increase from 6.3% to 9.0% if oil prices remained at $68/barrel. based on the latest doe estimate of $98/barrel, california now estimates that the state's unemployment rate could increase to 11.5% during 1981. this estimate is in contrast with the federal government's unemployment projections for the nation. at present, the federal government estimates the national unemployment rate will increase from 7.4% in the first quarter of 1981 to 10.3% in the fourth quarter of 1981.

california continues to remain in the pre-emergency phase of its emergency response. in accordance with the state's energy emergency plan, the governor has directed the department of social services and the employment development department to begin administrative preparations for distributing additional revenues to relieve economic hardships resulting from the april/may price shock. this action was taken in anticipation of either the direct receipt of federal block grants, or the passage of an oil severance tax in the event that federal funds are not forthcoming.

also in conjunction with the pre-emergency phase the governor has been meeting with members of the energy suppliers advisory committee and the energy consumers advisory committee. members of the energy suppliers advisory committee have been asking the governor not support the use of oil price controls. the governor took a position with the committee that if the oil industry would further reduce inventories he would not recommend price controls at this time. the governor noted, however, that he may review his position if the federal government refuses to use the spr and does not assist states through block grants. in meetings with the energy consumers advisory committee the governor was encouraged to continue his persuasion of the federal government to activate the spr and distribute windfall profits tax revenues to states for hardship assistance.

late friday afternoon in an impromptu new conference the governor announced that he and california energy officials would be flying to washington d.c. on sunday, and would be attending the governors' meeting with the president on monday, may 9.

Disposition: 00

To: Y.ALLENA (DOE400)
From: A.GANDARA-CA (DOE468) Posted: Sun 8-May-83 10:33 Sys 63 (47)
Subject: upi/ap press report

****

this message is for the purposes of the ast4 test only and has no relationship to events in the real world.

****

GOVERNOR SAYS GASOLINE PRICE CRISIS IS FEDERAL PROBLEM

upi/ap reports

[illegible]

SACRAMENTO - yesterday the governor announced that he and his staff of energy officials would be attending a may 9 meeting with the president on the nations developing gasoline emergency problem. this meeting, organized by the national governor's association, will rpovide u.s. governor's an opportunity to pass along to the president some of the pressures being felt as a result of skyrocketing gasoline prices and federal government inaction.

in an impromptu news conference late friday afternoon the governor stated that, "the responsibility for responding to higher fuel prices and their increasing impacts on the poor lies first with the federal government. hopefully the governors can convince the president to somehow use the nation's strategic petroleum reserve to slow down the increase ingasoline prices, and use additional windfall profits tax revenues to aid states in assisting the poor."

to a question concerning his position on the oil severence tax bill now being debated by the california legislature, the governor offered qualified support by declaring that, "if the federal government provides adequate assistance to states during this crisis period, there will be no need to tax california's oil production. if for some reason the president does not make emergency funds abailable to states, then california will have to consider all possibilities for protecting the economic well-being of its people and its businesses."

the governor concluded his discussion with reporters by stating that oil price controls can still be averted if the federal government acts promptly. if not, the governor feels that the u.s. congress will take matters into its own hands.

during the past few weeks the governor has come under criticism for not proclaiming a statewide emergency in california. however, it has been learned from sources inside the governor's office that a decision will be made soon after the may 9 meeting with the president. a proclaimed state of emergency will formally activate statewide government programs that can be used in responding to both fuel supply and economic hardships.

0270

To: Y.ALLENA (DOE400)
From: A.CANDARA-CA (DOE468) Posted: Sun 8-May-83 10:30 Sys 63 (39)
Subject: emergency fuel switching be california's electric utilities

70 only

****
this message is for the purposes of the est4 test only and has no relationship to events in the real world.
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during the first quarter of 1981, 27% of california's electricity was generated from residual fuel oil (167,541 b/d). during this same period, 36% of california's electricity was generated from natural gas (1.3 bcf/d).

Energy 270

as the second quarter of 1981 began and the emergency condition became more apparent, california's electric utilities were already switching away from oil in favor of natural gas. (this switching occurs each year due to the increased availability of natural gas during the summer months.) based on utility supply plans filed with the california energy commission prior to the current emergency, oil-fired generation within the state would have been reduced to 14% of the state's total electric generation (93,500 b/d), and gas-fired generaion would have increased to 48% of the state's total electric generation (1.9 bcf/d).

and internal doe message (may 3, doe#0154) indicates that no natural gas supply problems are anticipated in relation to est4. the message goes on to state that "enough surplus gas is available (2.4 bcf/d) to displace 400,000 barrels of fuel oil per day; or more than the estimated oil use by electric utilities and industrial plants available for displacement i.e. 330,000 barrels per day."

on the basis of this doe message, california is assuming that all of the state's electric utilities have displaced their scheduled oil use during the second quarter of 1981 (93,500 b/d) with natural gas. as a result of this action, california's electric utilities will consume an additional 0.6 bcf/d of natural gas during this second quarter (25% of what doe estimates is available for the nation as a whole). in doing so, california's utilities have accounted for 93,500 b/d of the 330,000 b/d of displacement that doe indicates is available nationwide (28%).

the 93,500 b/d of residual fuel oil displaced in california is now presumably available for export to other parts of the united states.

To: T.ALLENA (DOE400)
From: A.GONZAGA-CA (DOE400) Posted: Sun 6-May-83 10:47 Sys 63 (59)
Subject: california inquiries - package #1

#0269

****

this message is for the purposes of the set4 test only and has no relationship to the real world.

****

PLEASE PROVIDE RESPONSES TO THE FOLLOWING:

Inventory order

1. on april 26 doe requested information from the director of naval petroleum and oil shale reserves concerning spr surge capacity (doe#0036). was this information ever provided? if so, please forward all information received concerning the elk hills naval reserve. check w/ ? O.K See E0012

2. as late as may 3 doe indicated that the fill of the strategic petroleum reserve was continuing (doe#0237). is the spr being filled with $98/barrel oil? O.K old

3. doe has noted that it would be obtaining information on world oil movements from intelligence agencies (doe#0092). can information concerning tanker movements between u.s. ports be supplied to states? — Jones act — Get from E On hold NO

4. on april 28 doe requested information from the interstate oil compact commission concerning oil and gas surge capabilities within the united states (set msg 108). was this information ever provided? please forward any information received concerning california's oil and/or gas surge production. also provide background information on the regulatory responsibilities of the "interstate oil compact commission." E ✓

5. with regard to the table that accompanied your request for a status report on available nuclear generating capacity (doe#0102), how does "available capacity relate to the "power available" notation? what does the notation "n.b." refer to? O.K

6. on may 3 doe directed the assistant secretary of conservation and renewable resources to review potential voluntary conservation measures (doe#0172). what additional voluntary response does doe expect to benefit from subsequent to implementation of state voluntary programs and a 52% increase in gasoline prices? why has doe waited until AFTER gasoline prices have increased to investigate the benefits of voluntary demand restraint? Bill ?

7. with regard to the potential fuel oil problem noted by states in the northeast (doe#131a, doe#0203), what consideration is being given to meeting this need with natural gas? if this option is being explored, how might the availability of natural gas on the west coast be affected, especially now that 62% of california's electricity is being generated by natural gas? Alternate to any possible allow E/A or IA

8. can doe provide by may 13 a summary of set4-adjusted eia-800 forms submitted by california nine major prime suppliers* for the week ending may 6? if not, can doe provide a breakdown of how much alaskan oil, indonesian oil and california oil is being imputed to california's refineries as of may 6? O.K

*chevron, union, arco, shell, tosco, mobil, exxon, texaco, getty

#0269

To: A. Gandara-C[illegible] (D[illegible]16[illegible]

Subject: AST4 Control Number 0269, Reply to California Inquiries

This message is for the purpose of AST4 Test only and has no relationship to the real world.

1. The reply to the request for NPR surge capacity (DOE #0036) provided by Capt. Gilmore (# 0162, May 2) states that the average daily production at NPR-1 (ELK Hills) ~~naval reserve)~~ is approximately 158,000 BOPD in which the Government's share is 124,000 BOPD. When the temporary emergency plan is in effect, the Government's share will increase to approximately 141,500 BOPD. The message also included the draft documents for authorizing NPR-1 to operate at an emergency rate for 90 days, should this become necessary.

2. The price of the petroleum with which the SPR is being filled depends on whether it was purchased on long term contract or on the spot market. All the spot market and term purchases with escalator clauses are priced at $98.00/B. SPR fill purchased under long term contracts with no escalator will be at a price lower than $98.00/B.

3. Information on U.S. tanker movements between U.S. Ports is not an intelligence activity. Neither the Maritime Administration nor the Maritime Commission keep current and readily available information on these movements. We will continue to look for a source that might be available under emergency circumstances.

4. U.S. NESO has not yet received a response to its request (# 0108) to the Interstate Oil Compact Commission for information on oil and gas surge capabilities.

5. On the Table, "Nuclear Generation, Commercial Operating Units," "Available Capacity" represents additional MWs from plants operating at less than 100%. "Available Power" is the average generation from all plants, including those operating at less than 100%. The term N.B. is a Latin abbreviation for footnote, meaning "Notewell."

6. TBD.

7. The use of natural gas as a substitute for fuel oil is expected to take place in the Northeast and other regions. Based on our analysis of natural gas supply, consumption of additional natural gas in the Northeast, however, will not affect the availability of natural gas to California.

8. For this simulated emergency, the normal submissions of EIA forms (such as the EIA800) DO NOT TAKE PLACE. Based on conversations with oil companies, we anticipate near normal availability of indigenous California crude. While no breakdown is available on how much Alaskan, Indonesian, and California oil is being inputed to California refineries, the oil companies indicate that some Alaskan and Indonesian Crude is being diverted to other destinations.

LODC

0270

10 only

To: T.ALLENA (DOE400)
From: A.CAMPARA-CA (DOE468) Posted: Sun 8-May-83 10:30 Sys 63 (39)
Subject: emergency fuel switching by california's electric utilities

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this message is for the purposes of the aet4 test only and has no relationship to events in the real world.

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during the first quarter of 1981, 27% of california's electricity was generated from residual fuel oil (167,341 b/d). during this same period, 36% of california's electricity was generated from natural gas (1.3 bcf/d).

Energy 270

as the second quarter of 1981 began and the emergency condition became more apparent, california's electric utilities were already switching away from oil in favor of natural gas. (this switching occurs each year due to the increased availability of natural gas during the summer months.) based on utility supply plans filed with the california energy commission prior to the current emergency, oil-fired generation within the state would have been reduced to 14% of the state's total electric generation (93,500 b/d), and gas-fired generaion would have increased to 48% of the state's total electric generation (1.9 bcf/d).

and internal doe message (may 3, doe#0134) indicates that no natural gas supply problems are anticipated in relation to aet4. the message goes on to state that "enough surplus gas is available (2.4 bcf/d) to displace 400,000 barrels of fuel oil per day; or more than the estimated oil use by electric utilities and industrial plants available for displacement i.e. 330,000 barrels per day."

on the basis of this doe message, california is assuming that all of the state's electric utilities have displaced their scheduled oil use during the second quarter of 1981 (93,500 b/d) with natural gas. as a result of this action, california's electric utilities will consume an additional 0.6 bcf/d of natural gas during this second quarter (25% of what doe estimates is available for the nation as a whole). in doing so, california's utilities have accounted for 93,500 b/d of the 330,000 b/d of displacement that doe indicates is available nationwide (28%).

the 93,500 b/d of residual fuel oil displaced in california is now presumably available for export to other parts of the united states.

To: H.WENTZEL-ME (DOE413)
To: J.EDWARDS-NY (DOE417)
To: H.GILL-WY (DOE434)
To: M.MASSEY-WI (DOE447)
To: W.BALL-MS (DOE467)
To: D.WALKER-FL (DOE470)
To: R.DUMAS-VT (DOE483)
To: J.GOODING-TX (DOE485)
To: L.GOLTZ-KA (DOE500)
Cc: Y.ALLENA (DOE400)
From: T.RAUH-CA (DOE468) Posted: Thu 28-Apr-83 18:43 Sys 63 (156)
To: A.GANDARA-CA (DOE468)
Subject: california emergency action - first quarter 1981

#0278

this message is for purposes of the ast4 test only and has no relationship to events in the real world.

MAY 1, 1981

in response to the world oil supply disruptions which began in DECEMBER of 1980 the california energy commission activated the verification phase of california's energy emergency response. during the month of JANUARY the chairperson of the commission directed staff to determine the state's existing energy situation. commission staff contected energy suppliers and the federal government to obtain data and intelligence concerning the impending shortage. staff found no immediate impacts to the state of california, but noted that the shortfall to the u.s. as a whole could be as high as 10%. staff indicated that if the shortage persisted or became worse, a strong likelihood existed that indonesian and alaskan oil could be redirected away from california as a result of national iea commitments or changing market conditions. staff also noted that such redirections could lead to a substantial increase in oil prices.

in a FEBRUARY meeting with the governor the chairperson recommended that the pre-emergency phase of california's energy emergency response be activated. on the basis of this recommendation, and information received from california's major oil companies that caliornia oil supplies are being redirected to meet company contract committments nationwide, the governor activated the pre-emergency phase on MARCH 1, 1981. in conjunction with this action the governor delivered a televised address. his statement contained the following elements:

- a general appeal for the public to reduce its gasoline use in order to hold down gasoline prices;

- a request that county governments voluntarily implement the emergency ridesharing, transit and public information components of their gasoline emergency plans;

- an appeal for businesses and industries to voluntarily implement emergency energy conservation programs, draw down fuel inventories, and where possible, switch from oil to natural gas;

- issuance of an executive order requiring specific energy use reductions in state government operations;

- establishment of an energy emergency center (at the california energy commission) to collect and coordinate the flow of data and information during the emergency period; and

- establishment of an energy suppliers advisory committee and an energy consumers advisory committee for the purpose of receiving assistance from the private sector in interpreting the emergency condition.

in response to the governor's televised statement, county governments associated with california's major metropolitan areas implemented their gasoline emergency plans. all of these plans were in place by APRIL 1, 1981.

DURING THE MONTH OF APRIL gasoline prices in california increased from an average of $1.44 per gallon to $2.19 per gallon. diesel fuel prices increased from an average of $1.24 per gallon to $1.95 per gallon. these rapid price increases created substantial problems for the state of california:

- the tourist industry complained that government inaction had all but eliminated pleasure travel in the states of california

8278

and nevada;

- farmers announced that high fuel prices would be passed on to consumers by july. (the april price shock occurred at a critical period in california's planting and harvesting cycle. completion of seasonal harvests of avocados, sugar beets, citrus fruits and grains have been threatened, and some farmers have switched away from seasonal plantings of rice, cotton and beans for less energy-intensive crops.)

- representatives of low-income groups intensively lobbied california's elected officials for the establishment of a special state fund to help the poor in coping with the emergency condition. to obtain revenue for this fund, a bill is rapidly moving through the california legislature to establish a 5% severance tax on oil production within the state.

- local governments reported forced reductions in government services due to the high cost of fuel. the demand for local welfare services has increased substantially. transit services have already reached capacity.

- sporadic incidents of violence at retail gasoline outlets have been reported. incidents are stemming from objections to "unfair" pricing.

preliminary analyses have been completed on the impacts of increased gasoline price on california's gasoline demand. while the national average for gasoline price elasticity appears to be -.15, california's specific elasticity is approximately -.10. while no numbers have been received concerning the state diesel price elasticity, it is much lower than the national average which was indicated at -.15. the insensitivity of california's diesel demand to increasing price is primarily attributable to the heavy agricultural and trucking activity now occurring within the state.

preliminary estimates of economic impacts have also been completed. economic analyses indicate an expected 5% decrease in the gross state product for california during 1981. this decrease will be accompanied by a 4% reduction in employment (10.7 million to 10.3 million), increasing the state unemployment rate from 6.5% to 9.0%.

california is currently performing an analysis of price shock impacts on fuel switching from oil to natural gas. the results of this analysis will be made available when it is completed.

DURING THE PAST WEEK the governor of california has been in touch with governors in other padd v states. it was learned that these states have taken similar demand reduction steps during the month of april. a majority of padd v states have encouraged their congressional delegations to take action to halt the rapid increase in petroleum prices, and provide federal assistance to states for the purpose of relieving economic hardships caused by the april price shock. if the price of petroleum products continues to increase during may, padd v states are in agreement that they will EXPECT federal assistance in either controlling price or distributing block grants. at least one state has stated that it will actively lobby for reinstatement of price and allocation controls in order to be assured of receiving their fair share of oil supplies.

during the past few days the governor of california has been in daily contact with the california congressional delegation. the governor has emphasized to the delegation the need for a drawdown of the spr in order to control any additional oil price increases. the governor has also stressed the need for economic relief at the federal level in the form of block grants to states for the purpose of assisting the non-working poor. the governor made a personal appeal for federal action in a 45 minute telephone conversation with the president on april 30, 1981.

NOTE: please forward this message to all padd v states, california local governments (doe511) and the national governors association.

commissioner arturo gandara
presiding member, fuels planning committee.
california energy commission

Comments from: A.GANDARA-CA (DOE468) Posted: Sun 8-May-83 10:14 Sys 63

california transmitted this message to doe on april 28, 1983. based on your telephone calls and "message" inquiries, this first california message was never retransmitted by doe. it is being provided directly to you at this time so that you may have a better understanding of california's initial interpretation of the ast4 scenario and our "simulated" emergency response.

Disposition: file
Filed

Disposition: file pending
Filed in category PENDING

Disposition: d

read # 0335

To: Y.ALLENA (DOE400)
From: A.GANDARA-CA (DOE468) Posted: Thu 12-May-83 13:47 Sys 64 (7)
Subject: status of california inquiries - package 1

on sunday, may 8, california transmitted to doe a series of questions concerning cycle 1 of the ast4 simulation. many of these questions required only a "yes or "no" answer. we would appreciate a response to our questions by may 13. if this response is not forthcoming by the end of this week, please indicate the earliest date on which we can expect a doe reply.

[illegible] DISTRIBUTION CONTROL# 0380

Fo J.BROWN (DOE402)
From T.DOWD (DOE515) Posted Fri 13-May-83 11 38 Sys 64 (61)
To Y.ALLENA (DOE400)
Subject TEST FOR RECEIPT OF READABLE COPY

#0380

To ROBERT PRESLEY
From W. T. Dowd (DOE515)
Subject Surge Oil and Gas Capability (AST MSG108)
AST-4 TEST MESSAGE

This message is for purposes of the ast-4 test only and has no relationship to the events of the real world.

Pursuant to the request cited above, the several producing states have been contacted to determine the amount of surge capacity for oil and gas in the United States. The term has been defined similarly to that found in the publication "Emergency Preparedness for Interuption of Petroleum Imports Into the United States" National Petroleum Council 1982. The basic assumptions as to crude oil are that first the increase in production will be limited to that extra producing capacity which may be allowed without ultimate damage to the reservoirs and without loss of ultimate recoverable reserves secondly the transportation facilities exist or will be available at the same time that the excess producing capacity is available. It is also presumed that no flaring of natural gas will be permitted

Accordingly the following states have reported the corresponding amounts

State	Barrels per Day
Texas	117 000
Oklahoma	37 000
Kansas	15 000
California	12 000
Wyoming	10 000
Total	226 000

Please note the California figures do not include Elk Hills. Similarly no effort has been made to determine the surge capacity of oil and gas produced offshore under the jurisdiction of the Minerals Management Service. It should also be noted that there is an excess capacity of at least 30.000 barrels per day in Alaska which cannot be produced because of pumping limitations on the Trans-Alaskan Pipeline. No effort was made to determine how long it would take to modify the facilities.

We discussed with the state the surge capacity of natural gas in general terms. This is much more complex than crude oil. There is certainly a volume of additional gas which is available at this time. There is no difficulty in projecting that natural gas production nationally could be at a rate of 56 billion cubic feet a day as compared to the February 1983 production of approximately 48 billion cfd. The pipelines have historically handled volumes of this level. The question is whether this amount is usable. Storage facilities are generally near full at this time The warm weather will reduce residential demand for natural gas for the next six monhts. But the question remains as to the amount of fuel switching availability.

D380

"One other factor might be considered in connection with the supply of domestic crude oil. The depressed economic condition of the oil industry and the decrease in drilling in the past several months has resulted in a number of idle drilling rigs and a surplus of available crews. The $98 per barrel crude oil price will undoubtedly stimulate exploration for known deposits of oil at shallow levels. A stripper well that had to be abandoned at three barrels a day because it was uneconomic at $30 a barrel can possibly be redrilled in a matter of day if the gross income is $294 a day. This amount cannot be quantified but in my opinion could add a siginificant number of barrels within 90-120 days."

#0483

To: A. GANDARA-CA

From: U.S. NESO

Subject: Response to AST-4 Msg (DOE #0377)

****
this message is for the purpose of the ast 4 test only and has no relationship to events in the real world.
****

IN THE SUBJECT MESSAGE, CALIFORNIA INDICATES THAT DIESEL FUEL DEMAND IS RELATIVELY UNAFFECTED BY PRICE SINCE DIRECT CONSUMERS CAN PASS THE COST ON TO CUSTOMERS. IT FURTHER INDICATES A SEPARATE CALIFORNIA PRICE OF $3.50 PER GALLON FOR DIESEL FUEL RATHER THAN THE NATIONAL AVERAGE OF $2.70 PER GALLON.

THE 80¢/GAL PRICE DIFFERENCE WOULD DRAW FUEL FROM THE OTHER AREAS RATHER QUICKLY UNLESS THERE WERE MAJOR TRANSPORTATION DIFFICULTIES. DOES CALIFORNIA ASSUME THAT SUCH DIFFICULTIES EXIST AND ARE SO SEVERE AS TO PREVENT A MARKET ADJUSTMENT? IF SO, PLEASE INFORM THE NESO AS SOON AS POSSIBLE.

Glenn H. Coplon

Glenn H. Coplon
M & D Group

From A.GANDARA-CA (DOE468) Posted Tue 17-May-83 11 15 Sys 64 (66)
Subject response to mississippi request for set-aside program information

ATTENTION STATE OF MISSISSIPPI

0385

lifornia's proposed emergency set-aside program is driven by the following licy conclusions

- all fuel released through the set-aside program will be sold at the prevailing market price
- set-aside percentages will be set as low as possible to reduce impacts on the general distrbutionn system
- the governor will be responsible for activating the set-aside program.

components of california's proposes set-aside program include the following

- end-users are classified into two priority groups. if total set-aside volumes requested exceed the amount of the actual set-aside then priority group 1 applicants are served first.
- the set-aside percentages are gasoline - 2%
  diesel - 4%
  aviation gasoline - 2%
  all other products - 2%
- set-aside fuel not allocated by thd 20th of the month is released back to the prime suppliers.
- prime suppliers will report their set-aside volumes on form eia-782c. which must be sent 10 days prior to the first day of the report month.
- priority group 1 includes
  - agricultural production including agricultural trucking and agricultural aviation
  - aviation ground support vehicles and equipment
  - cargo freight and mail hauling by truck including diesel truck stations
  - emergency services
  - energy production
  - health care facilities
  - non-military marine shipping
  - public passenger transportation services
  - sanitation services
  - snow removal and other non-normative road service and
  - telecommunications services.
- priority group 2 includes
  - all other bulk purchasing end-users and wholesale purchase [illegible]

#0420

read

To T.ALLENA (DOE400)
To T.DOWD (DOE515)
From T.DOWD (DOE515) Posted Wed 18-May-83 14 41 Sys 64 (40)
Subject RESPONSE TO SYS 64 (24)

2. Reference is made to SYS 64 (70) which was the DOE response to California's questions. On 14 May 83 Winkler advised California "U.S. NESO has not yet received a response to its request (1018) to the Interstate Oil Compact Commission for information on oil and gas surge capability." This is incorrect by any standard of measurement. I would appreciate a clarification to California that we did respond timely that we reported surge capabilities in California of 12 000 barrels per day exclusive of Elk Hills and that in further response to their question the IOCC has no regulatory responsibilities but obtains its information from state sources specifically including M. G. Mefferd Division of Oil Gas State of California

#0420

In the last two weeks my secretary has spent at least one half of her time learning to communicate with Dialcom and attempting to work out the bugs. I understand the difficulties that are being encountered during this test but would appreciate the clarification requested above.

W. Timothy Dowd

Disposition d

End of Scanned Mail.

received #370

380 sent d

- rec'd

306 - asked

#05[illegible]

#0506
P1 of 3

To: Y.ALLENA (DOE400)
From: A.GANDARA-CA (DOE468) Posted: Sun 22-May-83 13:34 Sys 64 (95)
Subject: status of california's emergency condition

****
this message is for the purpose of the ast4 test only and has no relationship to events in the real world.
****

MAY 20, 1981

nearly 300 truck rigs circled the state capitol last tuesday as california's independent truckers brought their protest of higher fuel prices to sacramento. in a speech delivered from the capitol steps, a representative of the independent truckers declared that the group had demonstrated unprecedented patience with government's response to recent fuel price increases. he noted that, "the time had come for government to be reminded that people who drive trucks are just as important as those that produce and sell oil."

also on tuesday the cec chairperson and emergency center staff met with members of the energy suppliers advisory committee on the potential diesel fuel problem developing in california. as a result of this meeting it was determined that changes in product demands would increase the availability of diesel fuel within the state. most notably, the increased use of natural gas by california's electric utilities has reduced demand for low-sulfur fuel oil. this reduction "frees up" distillate which is normally used as a fuel oil blend for meeting sulfur content restrictions in power plant fuels.

despite this increased availability of distillate fuel in california, it was agreed at the meeting that the price of diesel fuel within the state was likely to increase beyond the price of gasoline, and that diesel prices would likely be higher in california than other padd v states. substantial discussion at the meeting focused on the impact of this price differential between padd v states. it was concluded that:

P2 of 3 #0506

- less diesel fuel would be available to markets in arizona and nevada;
- prime suppliers would be constrained from redirecting diesel fuel supplies by contract restrictions, but independents would probably move diesel to california via the spot market;
- until additional supplies of diesel fuel are "allocated" to california by market forces, SPOT SHORTAGES ARE LIKELY TO CONTINUE; and
- if the price differential persists, diesel fuel would not only be tankered and trucked from other padd v states, but would be brought in from the gulf coast as well.

on the basis of information obtained at the energy suppliers advisory group meeting, projections of california diesel fuel prices computed by emergency center staff on monday were revised as follows:

	MAY	JUN	JUL
actual california consumption (mbd)	188.2	190.7	188.2
doe estimated ast4 demand restraint	18%	20%	21%
ca estimated ast4 demand restraint (after product adjustments)	15%	16%	17%
ca base price	$1.25	$1.25	$1.25
projected "average" ca price to obtain necessary demand restraint (-0.1 elasticity)	$3.12	$3.25	$3.37

P 3 of 3 #0506

this revised projection was presented to the governor and agency directors at a wednesday afternoon cabinet meeting. also at this meeting the secretary for the department of food and agriculture presented his report on the impacts of increased diesel prices on california's agricultural industry. the report concluded that the most serious impact of abrupt diesel price increases would be in relation to the export of fresh fruit and vegetables. this segment of california's agricultural industry accounts for 22.5 million tons of food production valued at 4.9 billion dollars. transportation costs are 11% to 70% of the total costs associated with exporting these crops. fresh fruits and vegetables compete in distant markets with other producing areas having lower transportation costs, so higher diesel fuel prices could jeopordize the viablility of these crops in markets outside the state.

the secretary of food and agriculture also commented on the impacts of an independent truckers strike. he noted that california farmers are dependent upon trucking and cannot readily switch to lower cost transportation modes (i.e. rail) because trucking is the only mode which guarantees deliveries on time and in quality condition. the secretary estimated that such a strike could significantly impact as many as 60 crops, and result in billions of dollars lost to the state's economy.

Disposition: d

End of Scanned Mail.

#0517

517

To: Y.ALLEND (DOE494)
From: A.GANDARA-CA (DOE468) Posted: Mon 23-May-83 12:43 Sys 64 (12)
Subject: Reply to: DOE Response to CALIFORNIA on Price of Diesel Fuel (DOE#0483)

@@@

this reply is for the purposes of the ast4 test only and has no relationship
to events in the real world.

@@

in response to message doe#0483 ("doe response to california on price of diesel fuel) transmitted on monday may 23, please see message transmitted to doe from california on sunday, may 22.

b. b. blevins
california energy commission

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   To:  Y.ALLENA   (DOE400)
 From:  A.GANDARA-CA  (DOE468) Posted:  Sat  28-May-83  14:58  Sys 64  (70)
Subject:  fema test message
 knowledgment Sent                                0518F

*****************************************************************************
this message is for the purposes of the ast4 test only and has no relationship
to events in the real world.
*****************************************************************************

the following fema message was received at the california office of emergency
services at 0922 on may 23, 1983:


NATL 179 CALI

060 05/23/3 1618Z


855 SWEC

DE NATL 1624 1431505
P 231503Z MAY 83
FM RONALD L WINKLER DEPUTY ASSISTANT SECRETARY FOR ENERGY
EMERGENCIES DOE WASHDC
TO CALI/ARTURO GANDARRA COMMISSIONER CALIFORNIA ENERGY COMMISSION
 .OR/DALE WALKER FLORIDA GOVERNORS ENERGY OFFICE
  NS/LYLE GOLTZ KANSAS ENERGY OFFICE
 AIN/NANCY WENTZEL MAINE OFFICE OF ENERGY RESOURCES
MISS/WILBUR BALL MISSISSIPPI DEPT OF ENERGY AND TRANSPORTATION
NYOR/JOHN EDWARDS NEW YORK STATE ENERGY OFFICE
TEXA/JOHN GOODING TEXA  ENERGY NATURAL RESOURCES ADVISORY COUNCIL
VERM/ROGER DUMAS VERMONT ENERGY OFFICE
WISC/MARY MASSEY STATE ENERGY DIVN WISCONSIN DEPT OF ADMINISTRATION
WYOM/NICHOLAS GILL WYOMING ENERGY CONSERVATION OFFICE
BT
UNCLAS
SUBJECT: DOE/AST-4 TEST MESSAGE VIA FEMA COMMUNICATION NETWORK
THIS IS A TEST MESSAGE TO STATE ENERGY OFFICES PARTICIPATING IN
THE DEPARTMENT OF ENERGYS (DOE) ALLOCATION SYSTEM TEST (AST-4)
EXERCISE.
A BACK-UP SYSTEM COULD BE ESSENTIAL FOR CONTINUITY AND SENSITIVITY
PURPOSES. DURING THE COURSE OF THE SIMULATION EXERCISE OR IN A
REAL EMERGENCY, THERE COULD BE A NEED TO TRANSMIT SENSITIVE
INFORMATION TO STATES OR THE ELECTRONIC MAIL SYSTEM (DIALCOM)
COULD FAIL.
SINCE FEMA MAINTAINS AN INTRICATE, INTERCONNECTIVE COMMUNICATION
SYSTEM THROUGHOUT THE COUNTRY, THIS MESSAGE IS BEING SENT TO YOU
VIA THAT SYSTEM.
PLEASE ACKNOWLEDGE RECEIPT OF THIS MESSAGE VIA DIALCOM UPON
DELIVERY TO YOU BY YOUR STATE FEMA OFFICE.
BT


NNNN#
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P.2 0518F

this message was received via the u.s. mail at the california energy commission on friday, may 27. when the caliornia office of emergency services was contacted and asked about their decision to notify the cec through the mail, they indicated that the message contained no direction or indication that there was a sense of urgency in the message's delivery. as a result, standard notification procedures were utilized. oes also noted that the text of the fema message was very confusing.

although the cec received notification on friday, may 20, that the fema test message was to be transmitted on monday. may 23, no attempt was made to notify or contact the california office of emergency services in advance or on the date of the message transmission.

b. blevins
california energy commission

Disposition: ffoo ddooee440022
Comments:
..sseenndd

J.BROWN -- Sent
Not Filed in category PENDING

Disposition: dd

[illegible] (DOE400)
From: A.GANDARA-CA (DOE468) Posted: Tue 24-May-83 18:45 Sys 64 (38)
Subject: status of california's emergency condition

****
this message is for the purpose of the ast4 test only and has no
relationship to events in the real world.
****

MAY 24, 1981

claiming that action had to be taken now to avert a serious economic crisis within the state, early this morning the california legislature passed a 5% emergency oil production severence tax. an additional $800 million will be added to state revenues in the next year as a result of this tax bill, and these funds will be made available to low-income groups through existing welfare and energy hardship programs. in a joint message by the speaker of the assembly and the senator pro tempore, the following statewide impacts were cited as providing the momentum behind the bill's speedy passage:

- a doubling of fuel prices during the past two months;
- a projected doubling of the state's unemployment rate during the next 12 months;
- a projected 10% drop in the state's manufacturing production; and
- a state government deficit of at least 500 million dollars during fiscal year 1982;

(speaker of the assembly noted that, "the legislature is not about to let california suffer an economic disaster because of federal government inaction. we have now provided the governor a means for protecting the future of our state. it is now time to help the disadvantaged citizens of our state who have been hardest hit by this national disaster."

the severence tax package was delivered to the governor's office this afternoon for signature.

Disposition: d

#035

TO: Y.ALLEMA (DOE400)
From: A.GANDAPA-CA (DOE468) Posted: Tue 24-May-83 16:38 Sys 64 (49)
Subject: califo.nia inquiries - package 2

Bantam DOH15

4410 DOH10

****

this message is for the purpose of the ast4 test only and has no relationship to events in the real world.

****

PLEASE PROVIDE RESPONSES TO THE FOLLOWING:

1. what portion of oil used to fill the strategic petroleum reserve during april and may ~~of 1981~~ was acquired through term purchases having escalator clauses? what portion was purchased from the spot market?

Donnie 2 not known

2. california never received a copy of capt. gilmore's message concerning elk hills surge capacity (doe#0162 - may 2). could you please transmit a copy of this message to us? ✓ — # See 0162

NLg Donna Ahrens

3. based on information submitted to the u.s. meso by u.s. oil companies, by how much will california's imports of alaskan and indonesian oil be reduced during may, 1981? — production

3. california reported that on may 1, 1981, use of residual fuel oil for electric generation within the state had been completely displaced by natural gas. has this information been reported to affected oil companies? are electric utilities continuing to purchase fuel oil? — # 266 the 3 — went to oil Co's — city Service Stand oil Calif Mobile

Ben Al

6. it is suspected that a residual fuel glut may develop in california as a result of emergency fuel switching to natural gas. has doe received any information concerning this glut or its extent? — Weekly

Ben

7. in responding to an inquiry from mississippi, doe indicated that, "at the beginning of may, gasoline is still on allocation at 95% but distillates supplies are at full market demand" (doe#0181). please explain this statement. why are oil companies ~~on an~~ allocation fraction in conjunction with the federal government's "free" market response? ✓ — check

Ben

8. in a message transmitted on may 16, the u.s. meso identified the amount of canadian natural gas available for export (doe#0351). is this amount what was historically available from canada during 1981, or has it been adjusted per the ast4 dispruption scenario? does the amount reflect canada's own emergency needs? ✓ now — no

Forman

9. in a message transmitted to the economic regulatory adminisration, doe requested information concerning the effect of the disruption scenario on the price of imported natural gas (doe#0303). ✓ was a response to this message ever received? were the petroleum prices provided by the doe message supposed to reflect actual prices after the disruption had occured?

Ben Abbe

Disposition: delete

End of Scanned Mail.

>mail qec

No mail at this time.

Companies are balancing supplies in order not to disclose # to any NSICA. — AL

We don't know because oil Co's not required to report the extent of disruption or

to 3 whether reallocate allocated

#0552

To: Y.ALLENA (DOE400)
From: A.GANDARA-CA (DOE468) Posted: Tue 24-May-83 18:45 Sys 64 (38)
Subject: status of california's emergency condition

****
this message is for the purpose of the ast4 test only and has no
relationship to events in the real world.
****

MAY 24, 1981

claiming that action had to be taken now to avert a serious economic crisis within the state, early this morning the california legislature passed a 5% emergency oil production severence tax. an additional $800 million will be added to state revenues in the next year as a result of this tax bill, and these funds will be made available to low-income groups through existing welfare and energy hardship programs. in a joint message by the speaker of the assembly and the senator pro tempore, the following statewide impacts were cited as providing the momentum behind the bill's speedy passage:

- a doubling of fuel prices during the past two months;
- a projected doubling of the state's unemployment rate during the next 12 months;
- a projected 10% drop in the state's manufacturing production; and
- a state government deficit of at least 500 million dollars during fiscal year 1982;

speaker of the assembly noted that, "the legislature is not about to let california suffer an economic disaster because of federal government inaction. we have now provided the governor a means for protecting the future of our state. it is now time to help the disadvantaged citizens of our state who have been hardest hit by this national disaster."

the severence tax package was delivered to the governor's office this afternoon for signature.

Disposition: d

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      To;  Y.ALLENA   (DOE400)
    From:  A.CANDARA-CA  (DOE468) Posted  Sun  29-May-83  16:28  Sys 64  (34)
Subject:  orange county message on defense contract impacts -
Acknowledgment Sent

*******************************************************************************
this message is for the purpose of the ast4 test only and has no
relationship to events in the real world.
*******************************************************************************

the following message from orange county was received at the california
emergency center on friday, may 27:

PLEASE BE ADVISED THAT CALIFORNIA DEFENSE CONTRACTORS ARE EXPERIENCING
DIFFICULTIES DUE TO THE ENERGY SITUATION.  INCREASED PRICES HAVE CAUSED
CASH FLOW PROBLEMS WITH NUMEROUS DEFENSE RELATED FIRMS.  MANY CONTRACTORS
ARE ATTEMPTING TO RE-NEGOTIATE THEIR FIRM FIXED PRICE CONTRACTS INTO
COST PLUS CONTRACTS.

SPOT SHORTAGES IN SELECTED ITEMS HAVE DEVELOPED AS MANY SMALL VENDORS
ARE NO LONGER ABLE TO MEET DELIVERY SCHEDULES.  SEVERAL CONTRACTORS HAVE
REPORTED THAT PRODUCTION DELAYS ARE LIKELY TO IMPACT ON MAJOR WEAPONS
SYSTEMS, LARGELY DUE TO SUBSCONTRACTORS FAILURE TO PROVIDE ORDERED PARTS
AND SUB-ASSEMBLIES.

PRODUCTION OPERATIONS CONTINUE, BUT AT A REDUCED RATE DUE TO SUCH FACTORS
AS RISING EMPLOYEE ABSENTEEISM, SPOT SHORTAGES OF RAW MATERIALS AND
ORDERED PARTS, AND CREDIT PROBLEMS STEMING FROM INCREASED PRICES AND CASH
FLOW DIFFICULTIES.  THIS RESULTS IN PRODUCTION DELAYS, CONTRACT
DELINQUENCIES, AND INCREASED PROCUREMENT COSTS.

NUMEROUS CONTRACTORS MAY DEFAULT ON THEIR CONTRACTS IF THE SITUATION
DOES NOT IMPROVE SOON!

K. PAUL RAVER
ORANGE COUNTY FUEL SHORTAGE
  COORDINATION COMMITTEE


Disposition:  ffoo  ddooee440022
Comments:
..seeonndd

J.BROWN  --  Sent

Disposition:  dd
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#0595

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     To:  [illegible]ALLENA   (DOE400)
   From:    [illegible]ANDARA-CA  (DOE468) Posted:  Thu  26-May-83  13:29  Sys 64  (11)
Subject:  crude oil prices outside the u.s.

********************************************************************************
this message is for the purposes of the ast4 test only and has no
relationship to events in the real world.
********************************************************************************

please provide the ast4 price of crude oil in the following
countries for may, 1981:  japan, united kingdom, france, west germany and
canada.  please provide a respone by noon est friday, may 26.

b. b. blevins
california energy commission

Disposition:  delete

End of Scanned Mail.

>off
Off At 14:09 05/26/83
Connect Mins = 4
Compute Secs = 21/26
```

595

#0619

To: Y.ALLENC (DOE416)
From: E.GAVETT (DOE557) Posted: Fri 27-May-83 15:14 Sys 64 (26)
Subject: CALIFORNIA'S EMERGENCY CONDITION

THIS MESSAGE IS FOR THE PURPOSE OF THE AST-4 TEST ONLY AND HAS NO RELATIONSHIP TO EVENTS IN THE REAL WORLD

INCREASED ENERGY COSTS OF TRANSPORTING FRESH FRUIT AND VEGETABLES TO MARKETS OUTSIDE CALIFORNIA WILL INCREASE SUBSTANTIALLY THE COST OF FOOD TO THE CONSUMER. IT MAY NOT HAVE AS LARGE AN IMPACT ON CALIFORNIA'SPRODUCE IN COMPETITION WITH PRODUCTION FROM OTHER AREAS HAVING LOWER TRANSPORTATION COSTS AS FIRST ENVISIONED.

MOST FRESH FRUITS ARE PERENNIAL CROPS, SO OTHER AREAS WOULD BE UNABLE TO CHANGE PRODUCTION LEVELS DURING THIS PRODUCTION SEASON.

A NUMBER OF FRESH VEGETABLES, HOWEVER, COULD BE PRODUCED IN AREAS CLOSER TO POPULATION CENTERS, BUT THEIR UNIT PRODUCTION COSTS HAVE BEEN HIGHER THAN CALIFORNIA'S COST OF PRODUCTION PLUS TRANSPORTATION HOW MUCH MORE PRODUCTION COMES FROM OTHER AREAS WILL DEPEND ON WHETHER THEY CAN COMPETE ECONOMICALLY UNDER HIGHER ENERGY PRICES.

ANOTHER FACTOR IS THE PRICE REQUIRED TO MOVE ADDITIONAL DISTILLATES TO THE PRODUCTION AREAS CLOSER TO MARKET TO ENABLE THEM TO INCREASE VEGETABLE PRODUCTION.THIS WILL ADD TO THEIR PRODUCTION COSTS.

FROM: EARLE GAVETT
DIRECTOR, OFFICE OF ENERGY, USDA

#F 0627

To: California

From: U.S. NESO

Subject: Crude Oil Prices Outside the U.S.

This is in reference to your question of May 26, 1983. For May 1981, the price of crude oil in Japan, U.K. France (not an IEA member), West Germany and Canada should approximate $98, plus or minus $1-2 to reflect transportation differentials and crude streams involved.

#0634

SUBJECT: DOE RESPONSES TO CALIFORNIA QUESTIONS, PACKAGE #2 (DOE #0551)

THE FOLLOWING ARE U.S. NESO'S ANSWERS TO CALIFORNIA QUESTIONS, PACKAGE #2, RECEIVED MAY 24 (DOE MESSAGE #0551). (NUMBERS CONFORM TO PACKAGE #2 NUMERICAL SEQUENCE - I.E., NUMBER 4 WAS NOT USED.)

1. Q. WHAT PORTION OF OIL USED TO FILL THE STRATEGIC PETROLEUM RESERVE DURING APRIL AND MAY OF 1981 WAS ACQUIRED THROUGH TERM PURCHASES HAVING ESCALATOR CLAUSES? WHAT PORTION WAS PURCHASED FROM THE SPOT MARKET?

   A. AS OF MAY 1, 1981, THE SPR CONTAINED ABOUT 135 MILLION BARRELS OF OIL, 3.8 MILLION BARRELS OF WHICH, OR 2.8%, WERE BOUGHT UNDER LONG TERM CONTRACTS WITH ESCALATOR CLAUSES. DOE BOUGHT THE REMAINDER OF SPR OIL ON THE SPOT MARKET.

2. Q. CALIFORNIA NEVER RECEIVED A COPY OF CAPT. GILMORE'S MESSAGE CONCERNING ELK HILLS SURGE CAPACITY (DOE #0162 - MAY 2). COULD YOU PLEASE TRANSMIT A COPY OF THIS MESSAGE TO US?

   A. MESSAGE #0162 WAS AN INTERNAL DOE MEMORANDUM FOR THE SECRETARY. THEREFORE, IT WAS NOT SENT VIA DIALCOM. THE INFORMATION EXTRAPOLATED FROM THAT MEMORANDUM WAS CORRECT AS REPORTED TO YOU IN DOE MESSAGE #348. PLEASE ACCEPT OUR APOLOGIES FOR IMPLYING OTHERWISE.

3. Q. BASED ON INFORMATION SUBMITTED TO THE U.S. NESO BY U.S. OIL COMPANIES, BY HOW MUCH WILL CALIFORNIA'S IMPORTS OF ALASKAN AND INDONESIAN OIL BE REDUCED DURING MAY 1981?

   A. WE CANNOT ANSWER THIS QUESTION BECAUSE UNDER THE AST-4 RULES, OIL COMPANIES DO NOT REPORT THE DESTINATION OF THEIR OIL SHIPMENTS. THE AMOUNT OF OIL RECEIVED BY EACH PARTICIPATING COUNTRY IS REPORTED. SINCE INTERNAL U.S. DISTRIBUTION DOES NOT FAVOR ANY STATE OR REGION, CALIFORNIA CAN EXPECT THE SAME 15% SUPPLY REDUCTION AS THE REST OF THE NATION.

5. Q. CALIFORNIA REPORTED THAT ON MAY 1, 1981, USE OF RESIDUAL FUEL OIL FOR ELECTRIC GENERATION WITHIN THE STATE HAD BEEN COMPLETELY DISPLACED BY NATURAL GAS. HAS THIS INFORMATION BEEN REPORTED TO AFFECTED OIL COMPANIES? ARE ELECTRIC UTILITIES CONTINUING TO PURCHASE FUEL OIL?

   A. U.S. NESO SENT YOUR MESSAGE ABOUT CALIFORNIA UTILITIES SWITCHING TO NATURAL GAS (DOE MESSAGE #0270) TO ALL AST-4 PARTICIPANTS, INCLUDING THE THREE OIL COMPANIES THAT PARTICIPATE: STANDARD OIL OF CALIFORNIA, CITY SERVICE AND MOBIL. WE ASSUME THAT CALIFORNIA UTILITIES, YOUR PUBLIC UTILITY COMMISSION OR YOUR ENERGY COMMISSION WILL SO INFORM THE OIL COMPANIES.

   SINCE YOU STATE IN THAT MESSAGE, "CALIFORNIA IS ASSUMING THAT ALL THE STATE'S ELECTRIC UTILITIES HAVE DISPLACED

#0634

(93,500 B/D) WITH NATURAL GAS," UTILITIES ARE NOT STILL BUYING FUEL OIL.

6. Q. IT IS SUSPECTED THAT A RESIDUAL FUEL GLUT MAY DEVELOP IN CALIFORNIA AS A RESULT OF EMERGENCY FUEL SWITCHING TO NATURAL GAS. HAS DOE RECEIVED ANY INFORMATION CONCERNING THIS GLUT OR ITS EXTENT?

   A. DOE HAS NOT HEARD OF SUCH A GLUT, NOR DO WE THINK IT WOULD DEVELOP. WE ASSUME THAT OTHER U.S. REGIONS WOULD ABSORB SURPLUS RESIDUAL OIL, PROVIDED THERE ARE NO TRANSPORTATION PROBLEMS. PLEASE LET US KNOW IF THERE ARE SUCH PROBLEMS.

7. Q. IN RESPONDING TO AN INQUIRY FROM MISSISSIPPI, DOE INDICATED THAT, "AT THE BEGINNING OF MAY, GASOLINE IS STILL ON ALLOCATION AT 95% BUT DISTILLATES SUPPLIES ARE AT FULL MARKET DEMAND" (DOE #0181). PLEASE EXPLAIN THIS STATEMENT. WHY ARE OIL COMPANIES ON AN ALLOCATION FRACTION IN CONJUNCTION WITH THE FEDERAL GOVERNMENT'S "FREE" MARKET RESPONSE?

   A. SINCE THE MARKET IS UNLIKELY TO REDISTRIBUTE INSTANTANEOUSLY SUPPLY FROM AREAS OF GLUT TO AREAS OF HIGHEST DEMAND, THERE MAY BE TEMPORARY LOCAL SHORTAGES DURING INITIAL ADJUSTMENT OF A MAJOR SUPPLY SHORTAGE. HOWEVER, SINCE SUPPLIERS GENERALLY ANTICIPATE DEMAND, ADJUSTMENTS ARE UNUSUALLY RAPID. COMPANIES MAY USE THEIR OWN INTERNAL ALLOCATION SYSTEMS TO HANDLE SHORTFALLS EQUITABLY IF SUCH COMPANIES CHOOSE NOT TO RAISE PRICES TO MARKET CLEARING LEVELS.

8. Q. IN A MESSAGE TRANSMITTED ON MAY 16, THE U.S. NESO IDENTIFIED THE AMOUNT OF CANADIAN NATURAL GAS AVAILABLE FOR EXPORT (DOE #0351). IS THIS AMOUNT WHAT WAS HISTORICALLY AVAILABLE FROM CANADA DURING 1981, OR HAS IT BEEN ADJUSTED PER THE AST-4 DISRUPTION SCENARIO? DOES THE AMOUNT REFLECT CANADA'S OWN EMERGENCY NEED?

   A. ON MAY 10 THE CANADIAN NESO TOLD US HOW MUCH CANADIAN GAS ABOVE HISTORICAL U.S. PURCHASES WOULD HAVE BEEN AVAILABLE FROM APRIL-JUNE, 1981 UNDER THE CONDITIONS OUTLINED IN THE AST-4 DISRUPTION TELEX. (PLEASE REFER TO DOE MESSAGE #351.)

   WE ASSUME THAT THESE DATA REFLECT CANADA'S OWN EMERGENCY AND THAT CANADA IS NOT GOING TO SEND GAS TO THE U.S. WHICH ITS OWN PEOPLE NEED.

9. Q. IN A MESSAGE TRANSMITTED TO THE ECONOMIC REGULATORY ADMINISTRATION, DOE REQUESTED INFORMATION CONCERNING THE EFFECT OF THE DISRUPTION SCENARIO ON THE PRICE OF IMPORTED NATURAL GAS (DOE #0303). WAS A RESPONSE TO THIS MESSAGE EVER RECEIVED? WERE THE PETROLEUM PRICES PROVIDED BY THE DOE MESSAGE SUPPOSE TO REFLECT ACTUAL PRICES AFTER THE DISRUPTION HAD OCCURRED?

A. THE PRICES OF CRUDE OIL AND PRODUCT WHICH DOE PROVIDED REFLECT BOTH THE REAL 1981 AND ESTIMATES OF THE DISRUPTION IMPACT.

#0639

To: State of California

From: Jan Marfyak

Subject: Earthquate and Tornadoes Causing Supply Interruption (Simulation)

This message is for the purpose of the AST-4 Test only and has no relationship to events in the real world.

This is an exercise control message to simulate a State emergency to test response procedures and to assess how a State might handle such a problem.

Heavy rain during the last week, coupled with a moderate earthquake, has resulted in massive mud slides in the Tehachapi Mountains north of Los Angeles.

Workers cleaning up the area estimate that it could take as long as a week to clear roads in the area. The Tejon Pass has caused the greatest problem, virtually shutting down travel.

With major truck routes closed, refineries in Bakersfield are preparing to either reduce through-put or close down due to lack of storage capacity for resideual fuel oil.

Normally, trucks haul residual bunker fuel from Bakersfield to the Los Angeles/Long Beach port area. Due to the inability of trucks to move the fuel from Bakersfield and the possibility of refinery reductions, reduced availabilities of motor gasoline and diesel fuel are projected for the San Joaquin Valley.

For the Affected State, please advise us of the impacts and responses to this event. This message is for purposes of domestic AST-4 simulation only, and should not be considered for purposes of communications with the IEA, or for international AST-4 test purposes.

```
MAIL READ

Mail call (1 Read)

>

      To:  Y.ALLENA    (DOE400)
    From:  A.GANDARA-CA  (DOE468) Posted:  Thu  2-June-83  18:22  Sys 64  (163)
 Subject:  status of california's emergency condition

*******************************************************************************
this message is for the purpose of ast4 only and has no relationship
to events in the real world.
*******************************************************************************
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#652

JUNE 2, 1981

a variety of reports received this past week indicate that the emergency condition in california has become severe. in a meeting with the governor this morning several agency and department directors provided an update of the situation.

the chairperson of the california energy commission provided an assessment of of local, state and PADD V emergency conditions. based on a telephone survey of local governments conducted over the memorial day weekend, it was learned that great variation exists in the retail price for gasoline. the spread from the lowest priced stations to the highest priced station is enormous by traditional standards. this phenomena is due partly to the very large range of prices at the wholesale level coupled with little ability among retailers to shop around, and the very different margins added on by retailers as a result of their pricing strategies.

refiner-operated stations are generally operating with the lowest retail prices. this pricing strategy seems to be designed to maximize the volume of throughput at these locations based on a 24-hour per day, 7-day per week operation. the prices at these stations are attracting motorists in very high numbers. as a result, lines and traffic congestion continue to be somewhat of a problem.

it now appears that refiner outlets, which represent about 10% of the total stations, are moving about 35% of the available gasoline. refiners are apparently adopting this pricing strategy because it maximizes their profitability while making the company-operated stations look good in the eyes of the public.

branded-lessee dealers generally are selling only about half the volume they would normally sell. the pricing at refiner-operated stations, plus a loss of market share, is causing most of the shortage problem to impact this group. some dealers, according to the service station association, are selling at very high prices featuring primarily no waiting for gasoline and good service. other dealers in this class are trying to maintain high volumes by pricing closer to the refiner outlets. they appear to be motivated differently: some are betting on price and allocation controls coming back (high volume = high allocation), while others are simply uncomfortable taking high-profits from their long-time customers.

private branders appear to be affected differently. those chain marketers with secure supplies are able to compete, others are struggling for supply and being priced at the top end [illegible] the market due to their high costs on the spot market.

refiners seem to be monitoring retail prices with an eye on capturing retailer profit by raising wholesale prices (this according to some of the service station operators). as the retail market establishes higher values for this commodity in scarce supply, the wholesale prices are being moved up taking away retailer margin. retailers are then countering by raising their retail prices to restore their margins to previous levels. as a result, retail prices are increasing rapidly, and are moving beyond those prices projected by doe. with many retailers' volumes down, their marketing costs are going up in terms of cents per gallon. this is because fixed costs are spread over fewer units (gallons of gasoline). as a result these retailers must make healthy margins just to break even. these factors continue to push prices up!

local governments also reported that violence and vandalism have increased substantially at retail outlets. motorists are angry and unable to understand the difference in price at some locations over others. a few high-priced retailers are demanding and receiving cash only in order to avoid credit card charges which amount to as much as 10 cents per gallon. also, stations are taking in cash ranging from $2000 to $10,000 per day. as a result, robberies and assaults at stations have increased dramatically. some stations are now arming themselves or employing private security guards.

finally, local government representatives noted that higher fuel costs plus increasing costs for food and other essential items are creating severe hardship among low and fixed income persons. crime of all types in less affluent communities has sharply increased.

at this point the cec chairperson noted that diesel prices are showing a similar pattern of variable price and unpredictable supply. while supply and price seem to be holding at acceptable levels in urban areas, markets in rural and agricultural areas seem to have gone wild. end-users in these areas are almost exclusively supplied by independent jobbers who have historically relied upon spot purchases and a variety of suppliers for fuel. furthermore, many agricultural areas rely upon cooperatives to purchase fuel. these cooperatives have generally less secure relationships with suppliers than do even the independent jobbers. these jobbers and cooperatives are now scrambling for fuel and paying the highest market prices. according to some reports this has even pitted jobber against jobber in uncontrolled price bidding wars. end-users depending on these jobbers are rapidly approaching their financial breaking point. because of the contrast between the diesel price situation in urban areas and rural areas, violence against tank-wagons is now being reported, and petroleum product suppliers are formally requesting protection for tank wagon deliveries.

the cec chairperson also noted that he talked to energy offices in other PADD V states and they indicated that they were experincing problems similar to those in california. tourist-oriented states also felt that florida's economic situation was very similar to their own.

in conclusion, the cec chairperson stated that the most recent information from the department of energy indicates that the international oil supply situation will continue to remain severe through the summer. the international energy agency has estimated the actual supply shortfall to iea member nations will be as high as 20% in july, but that direct

0652

in meeting u.s. supply obligations to fellow iea countries. california's situation can only be expected to become more severe during the summer months, which will mean even higher petroleum product prices.

the next presentation was given by the secretary for health and welfare. the secretary indicated that the doubling of fuel prices in april and may had substantially affected fixed-income and low-income households within california and the u.s. he noted that prior to the crisis, energy expenditures in the lowest u.s. income level (10%) represented 34% of total before-tax income. as a result of the current price shock this proportion has increased to 46%. in contrast, energy expenditures for the upper u.s. income level (10%) represented 6% of total before-tax income prior to the crisis. this post-crisis proportion has increased to 9%.

the director of the department of finance then noted that retail sales within the state were expected to decline by at least 7% during 1981 (9% during the last 3 quarters). this reduction is expected to result in an $8 billion dollar loss in retail activity.

the last presentation was given by the secretary of business and transportation. he was disturbed by doe reports (doc#0627) that other iea countries were allowing prices to increase at the same rate as that of the u.s. he noted that these other countries have publicly stated that they will use price controls during oil supply disruptions, and their is no reason to expect anything different in conjunction with THIS international emergency. if the u.s. market response is used in an environment where all other iea countries are using price controls, the secretary expressed fears that california businesses with markets outside the u.s. will be severely affected because of higher u.s. fuel costs. the oil-deficient countries will still continue to recieve oil supplies via the iea agreement no matter how much they restrict price. he maintained that if this situation occured, it could cost california's export market at least $15 billion dollars in the next year. the secretary was also fearful that the federal government's current proposal to lift export restrictions would further damage california's economy.

the cabinet meeting closed with a discussion of the federal government's reluctance to recognize the severity of the economic problems now facing california and the u.s. it was noted that low-income and fixed-income groups were being affected much more than expected. while the cabinet concluded that the federal government's "free market" response was not "breaking down", they agreed that it WAS creating unacceptable inequities in the distribution of the state's income and wealth. it was further agreed that the social costs associated with the federal response had become unacceptable. the cabinet strongly urged the governor to sign california's oil severence tax bill into law, and to take steps to control the petroleum product price panic now occuring within the state.

Disposition: DELETE

End of Mail.

Filed in category PENDING

#0666

Filed in category PENDING

Read or Scan: READ

```
     To:  D.WALKER-FL   (DOE470)
     Cc:  Y.ALLENA   (DOE400)
     Cc:  N.WENTZEL-ME   (DOE413)
     Cc:  J.EDWARDS-NY   (DOE417)
     Cc:  N.GILL-WY   (DOE434)
     Cc:  J.WEBB-NGA   (DOE435)
     Cc:  M.MASSEY-WI   (DOE447)
     Cc:  W.BALL-MS   (DOE467)
     Cc:  R.DUMAS-VT   (DOE483)
     Cc:  P.RAVER-CA   (DOE511)
     Cc:  N.GINN   (DOE543)
   From:  A.GANDARA-CA  (DOE468) Posted:  Fri  3-June-83  15:32  Sys 64  (15)
Subject:  padd v voting totals on chiles bill
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in the final senate vote today on the economic response bill introduced by senator chiles of florida, senators representing padd v states voted 11 in favor of the bill and 3 against. in addition to california, padd v includes alaska, arizona, hawaii, nevada, oregon and washington. the voting results for these states were obtained through a telephone survey conducted yesterday.

b. b. blevins
california energy commission

#0684

To: Y.ALLENC (DOE416)
From: M.DECKER (DOE538) Posted: Tue 7-June-83 11:34 Sys 64 (54)
To: R.WINKLER (DOE503)
ject: SUPPLY SITUATION IN CALIFORNIA

AS THE SITUATION IN CALIFORNIA, AS REPORTED BY A. GANDARA ON MAY 24, CLEARLY DEMONSTRATES, THERE IS A NEED FOR THE ADMINISTRATION AND CONGRESS TO QUICKLY REVIEW THE POTENTIAL BENEFIT OF CRUDE OIL PRODUCT PRICE AND SUPPLY ALLOCATION CONTROLS. A DOUBLING OF FUEL OIL PRICES WILL EXACERBATE A TENSE SITUATION FOR BOTH CONSUMERS AND PETROLEUM PRODUCT DISTRIBUTORS. OUR EXPERIENCE DEMONSTRATES THAT PRICE CONTROLS AND ALLOCATION OF PRODUCT ARE NECESSARY TO MAINTAIN PRODUCT FLOW EVENLY AND WITH MINIMAL DISTORTION. POST CONTROLS LOCKING A SUPPLIER TO A PURCHASER WERE FUNCTIONAL DURING EMERGENCIES, THEIR BIGGEST PROBLEM WAS THAT THEY WERE NOT LIFTED WHEN THE EMERGENCY SUBSIDED. NOJC REQUESTS THAT ADMINISTRATION AND CONGRESS SERIOUSLY CONSIDER REIMPOSING THESE CONTROLS WITH PROTECTION AGAINST THE CONTROLS CONTINUING INDEFINITELY.

SECONDLY, NOJC ESTIMATES THAT THE STORAGE CAPACITY AVAILABLE AT THE SECONDARY (JOBBER) LEVEL EXCEEDS 2.3 BILLION GALLONS. THIS BULK PLANT STORAGE IS OWNED OR LEASED BY THOUSANDS OF MARKETERS, THE MAJORITY IS LESS THAN 250,000 GALLONS PER BULK PLANT. HOWEVER, THIS IS VERY SUBSTANTIAL STORAGE THAT COULD AND SHOULD BE TAKEN INTO CONSIDERATION DURING AN EMERGENCY. AT THE TERTIARY LEVEL (HOMEOWNER) THE CAPACITY IS ESTIMATED TO BE APPROXIMATELY 4 BILLION GALLONS, AND THIS DOES NOT INCLUDE COMMERCIAL OR INDUSTRIAL STORAGE. THIS HOMEOWNER STORAGE IS GENERALLY INDIVIDUAL 275 GALLON TANKS. AN EFFECTIVE EMERGENCY RESPONSE OUGHT TO EVALUATE PROVIDING INCENTIVES FOR MARKETERS 2.3 BILLION GALLONS OF STORAGE CAPACITY) HOMEOWNER (4 BILLION GALLONS OF STORAGE CAPACITY) AND INDUSTRIAL AND COMMERCIAL STORAGE

CILITIES (UNABLE TO ESTIMATE, BUT SUBSTANTIAL) TO MAINTAIN STOCKS OF GASOLINE, HEATING OIL AND OTHER PETROLEUM PRODUCTS.

Comments from: R.WINKLER (DOE503) Posted: Tue 7-June-83 15:55 Sys 64

To: Y.ALLENA (DOE400)
From: P.RAVER-CA (DOE511) Posted 7-June-83 16:22 Sys 64 (58)
Subject: LOCAL GOVERNMENT RESPOSE TO DOE QUESTIONS RE. DEFENSE CONTRACT

RECEIVED
1983 JUN -7 PM 5 32

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AST-4 TEST MESSAGE
THIS MESSAGE IS FOR PURPOSES OF THE AST-4 TEST ONLY AND HAS NO RELATIONSHIP TO EVENTS IN THE REAL WORLD

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WILLIAM A. VAUGHAN, HEAD
U.S. NESO

ORANGE COUNTY 0688

IN RESPONSE TO YOUR MESSAGE OF 6 JUNE 83, REQUESTING CLARIFICATION OF DEFENSE SUBCONTRACTOR DIFFICULTIES, THE FOLLOWING IS PROVIDED:

AS THE MARKET SYSTEM IS ALLOCATING SUPPLY, THE PROBLEMS REFERRED TO IN OUR 29 MAY 83, MESSAGE RELATES TO ECONOMIC DIFFICULTIES OF SMALL DEFENSE SUBCONTRACTORS.

CENTRAL TO THESE COMMON DIFFICULTIES ARE THE "FIXED PRICE" CONTRACTS AND THE RESULTING INABILITY OF THE SUBCONTRACTORS TO PASS INCREASES OPERATING, MATERIAL AND PERSONNEL COSTS ON TO PRIMARY CONTRACTORS. UNLESS THERE IS GREATER FLEXIBILITY PROVIDED FOR THROUGH AMENDING FIXED PRICE CONTRACTS TO COST PLUS CONTRACTS, MAJOR DEFENSE SYSTEMS AND SUB-SYSTEMS ARE SUBJECT TO PRODUCTION DELAYS.

CONTRACT FLEXIBILITY IS NEEDED NOT ONLY TO ENABLE SUBCONTRACTORS TO RECOVER THE AFOREMENTIONED COST INCREASES, BUT IT IS ALSO NEEDED TO SUPPORT THROUGH THE CONTRACTS EMPLOYEE TRANSIT REQUIREMENTS SUCH AS VANPOOLS, BUS PASSES AND OTHER FORMS OF RIDESHARING.

IT SHOULD BE NOTED, AND OF COURSE CONFIRMED THROUGH DOD, THAT THESE PROJECTED PRODUCTION DELAYS WILL BE UPON US MUCH SOONER THAN PAST EXPERIENCE WOULD SUGGEST.

IT IS OUR UNDERSTANDING THAT UNLIKE OUR 1973 AND 1979 FUEL SHORTAGE EXPERIENCES, FEEDSTOCKS AND PARTS INVENTORIES ARE LOW WITHIN BOTH THE PRIVATE SECTOR AND THE DEFENSE DEPARTMENT. THUS, THE AMOUNT OF TIME MANAGEMENT HAS AVAILABLE TO IT TO MAKE PRODUCTION "GO-NO GO" DECISIONS IS DECIDEDLY SHORTER THAN IN THE PAST. ACCORDINGLY, IF CONTRACTS CANNOT BE RENEGOTIATED IN A TIMELY MANNER, CASH FLOW AND INVENTORY PROBLEMS MAY FORCE SUBCONTRACTORS TO REDUCE THEIR WORK FORCE, AND THEREFORE THEIR PRODUCTION OUTPUT LEVELS, OR STOP PRODUCTION ALTOGETHER.

FOR YOUR ADDED INFORMATION, THERE ARE WITHIN THE LOS ANGELES REGION COMPUTERIZED RIDESHARING SERVICES AND STATE SUPPORTED VANPOOL PROGRAMS. IT WOULD APPEAR THAT THESE SYSTEMS, WITH THE HELP OF DOD, DOE AND THE STATE, COULD PROVIDE FOR A COORDINATED PROGRAM DESIGNED TO MEET THE NEEDS OF THE DEFENSE CONTRACTORS.

IF WE CAN BE OF ANY ASSISTANCE OR PROVIDE ANY ADDITIONAL INFORMATION, PLEASE CONTACT THE CALIFORNIA ENERGY COMMISSION OR US.

R. PAUL RAVER, COORDINATOR
ORANGE COUNTY FUEL SHORTAGE
COORDINATION COMMITTEE

#0691

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    To:  Y.ALLENA   (DOE400)
  From:  A.GANDARA-CA  (DOE468) Posted:  Tue  7-June-83  19:12  Sys 64  (217)
Subject:  status of california's emergency condition
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JUNE 7, 1981

the following text is from the governor's televised statement which was delivered tonight at 6:00 p.m. pst:

GOOD EVENING.

I WOULD LIKE TO SPEAK TO YOU TONIGHT ABOUT THE CONTINUING OIL PRICE PROBLEMS FACING CALIFORNIA. WHEN I SPOKE TO YOU LAST MARCH I STATED T[illegible] FUEL PRICES IN OUR STATE WOULD INCREASE SHARPLY. THESE PRICE INCREASES HAVE NOW OCCURRED. I ALSO APPEALED FOR YOUR EMERGENCY ASSISTANCE IN REDUCING CALIFORNIA OIL CONSUMPTION. YOUR RESPONSE TO MY APPEAL HAS BEEN OVERWHELMING. STEPS TAKEN BY INDIVIDUALS, BUSINESSES AND LOCAL GOVERNMENTS HAVE ACHIEVED SUBSTANTIAL ENERGY SAVINGS DURING THIS CRITICAL PERIOD. I COMMEND YOU ON THIS VOLUNTARY EFFORT.

UNFORTUNATELY, A NUMBER OF UNDESIRABLE SIDE-EFFECTS RELATED TO THE CURRENT EMERGENCY ARE BEGININNING TO APPEAR IN OUR STATE. LOW-INCOME AND FIXED-INCOME GROUPS HAVE BEEN SEVERLY AND UNFAIRLY IMPACTED BY THE RAPID FUEL PRICE INCREASE. REPORTS OF VIOLENCE AT SERVICE STATIONS AND AGAINST OIL SUPPLIERS HAVE INCREASED D[illegible]TICALLY. CONSUMERS IN RURAL AREAS OF THE STATE, FEARFUL THAT THEY WILL NOT BE ABLE TO OBTAIN FUEL AT ANY PRICE, ARE PAYING HIGHLY INFLATED PRICES FOR GASOLINE AND DIESEL FUEL.

GROUPS, LOCAL GOVERNMENTS AND MAJOR ENERGY CONSUMERS TO DISCUSS THESE DEVELOPING PROBLEMS, I AM CONVINCED THAT ACTION MUST BE TAKEN NOW TO PROTECT THE WELFARE OF CALIFORNIA AND ITS CITIZENS. IT IS MY BELIEF THAT THE ECONOMIC IMPACTS RESULTING FROM THE APRIL PRICE SHOCK SHOULD BE MANAGED BY THE FEDERAL GOVERNMENT. I ALSO BELIEVE THAT THE FEDERAL GOVERNMENT SHOULD IMPLEMENT THOSE PROGRAMS CONTAINED IN ITS ENERGY EMERGENCY RESPONSE PLAN DESIGNED TO SLOW THE OIL PRICE INCREASE AND PROVIDE FINANCIAL ASSISTANCE TO LOW AND FIXED INCOME GROUPS. THESE EMERGENCY PROGRAMS SPECIFICALLY INCLUDE A DRAWDOWN OF THE U.S. STRATEGIC PETROLEUM RESERVE AND THE DISTRIBUTION OF BLOCK GRANTS TO STATES FOR AUGMENTING FEDERALLY FUNDED HARDSHIP PROGRAMS. HOWEVER, DESPITE PERSONAL APPEALS BY MYSELF AND OTHER GOVERNORS, IT DOES NOT APPEAR THAT TIMELY ACTION WILL BE TAKEN BY THE FEDERAL GOVERNMENT. THIS PERCEPTION HAS BEEN REINFORCED BY RECENTLY PUBLISHED STATEMENTS MADE BY OFFICIALS INSIDE THE U.S. DEPARTMENT OF ENERGY. IN THE MEANTIME, BILLIONS OF DOLLARS IN WINDFALL PROFITS TAX REVENUES ARE BEING COLLECTED FROM THE OIL COMPANIES AND STORED IN THE U.S. TREASURY. AND CONDITIONS IN THE MIDDLE EAST CONTINUE TO DETERIORATE. ALTHOUGH THE U.S. CONGRESS IS LIKELY TO SEND THE PRESIDENT A BILL REQUIRING FEDERAL BLOCK GRANTS AND A DRAWDOWN OF THE STRATEGIC PETROLEUM RESERVE, IT IS NOT KNOWN WHETHER OR NOT THE PRESIDENT WILL EXERCISE HIS VETO POWERS.

GIVEN THE CERTAINTIES ASSOCIATED WITH THE SEVERITY OF THE CURRENT EMERGENCY AND ITS PROSPECTS FOR CONTINUING, AND GIVEN THE UNCERTAINTIES ASSOCIATED WITH THE IMPLEMENTATION OF NATIONAL EMERGENCY PROGRAMS, I MUST NOW ACT IN THE BEST INTEREST OF CALIFORNIA. AS A RESULT TONIGHT I AM FORMALLY PROCLAIMING AN EMERGENCY WITHIN OUR STATE, AND ACTIVATING THE EMERGENCY PHASE OF CALIFORNIA'S ENERGY SHORTAGE CONTINGENCY PLAN. IN CONJUNCTION WITH THIS PROCLAMATION, I AM IMPLEMENTING THREE PROGRAMS WHICH WILL ADDRESS THE PROBLEMS I HAVE PREVIOUSLY DESCRIBED.

FIRST, IN AN ATTEMPT TO RELIEVE THE TERRIBLE FINANCIAL BURDEN BEING ED ON THE LESS FORTUNATE CITIZENS OF OUR STATE LATER THIS EVENING I WILL SIGN THE CALIFORNIA OIL SEVERENCE TAX BILL PASSED BY THE LEGISLATURE LAST WEEK. MONIES COLLECTED FROM THIS TAX WILL BE USED TO AUGMENT EXISTING FEDERAL AND STATE PROGRAMS THAT NOW PROVIDE ASSISTANCE TO LOW AND FIXED INCOME GROUPS. THESE FUNDS WILL NOT BE USED TO OFFSET GENERAL REDUCTIONS IN STATE REVENUES RESULTING FROM THE EXISTING CRISIS.

SECOND, I AM ACTIVATING CALIFORNIA'S EMERGENCY FUEL SET-ASIDE PROGRAM FOR GASOLINE AND DIESEL FUEL. THIS PROGRAM WILL ENSURE THAT ALL CALIFORNIANS HAVE ACCESS TO FUEL SUPPLIES BY SETTING ASIDE A SMALL PORTION OF THE GASOLINE AND DIESEL FUEL RECEIVED BY CALIFORNIA'S MAJOR OIL COMPANIES EACH MONTH. THE CALIFORNIA ENERGY COMMISSION WILL THEN ALLOCATE THESE SUPPLIES TO THOSE UNABLE TO OBTAIN FUEL. I CALL YOUR ATTENTION TO THE FACT THAT THIS PROGRAM WILL ONLY PROVIDE ACCESS TO FUEL AND AS A RESULT WILL NOT PROVIDE FUEL AT A REDUCED PRICE. DETAILS OF THE SET-ASIDE PROGRAM WILL BE MADE AVAILBLE BY THE ENERGY COMMISSION IN THE NEXT FEW DAYS.

FINALLY, I AM ESTABLISHING A LAW ENFORCEMENT MUTUAL AID PROGRAM WHICH WILL ENABLE THE DEPLOYMENT OF PEACE OFFICERS FROM THROUGHOUT THE STATE TO SPECIFIC AREAS FOR MAINTAINING PUBLIC ORDER AND SAFETY. THE CALIFORNIA OFFICE OF EMERGENCY SERVICES WILL COORDINATE THIS EFFORT. I HAVE ALSO PLACED THE CALIFORNIA NATIONAL GUARD ON STANDBY ALERT. IN THE EVENT THAT VIOLENCE AGAINST THE STATE'S PETROLEUM SUPPLY DISTRIBUTION SYSTEM ESCALATES, THESE TROOPS WILL BE STATIONED AT REFINERIES, MAJOR STORAGE FACILITIES, AND IF NECESSARY RETAIL OUTLETS. WILL ALSO BE USED TO ESCORT PETROLEUM DISTRIBUTORS DELIVERING FUEL SUPPLIES BY TRUCK.

IF AT SOME LATER DATE THE FEDERAL GOVERNMENT ACTIVATES SPECIFIC EMERGENCY PROGRAMS, I WILL REASSESS THE STATE EMERGENCY PROGRAMS I HAVE IMPLEMENTED HERE TONIGHT. THESE STATE PROGRAMS WILL BE ADJUSTED OR DISCONTINUED IF THEY ARE FOUND TO BE REDUNDANT WITH SUBSEQUENT FEDERAL EMERGENCY ACTIONS.

0691

AS HAS BEEN THE CASE WITH PAST OIL SHORTAGES. THE DRAMATIC PRICE INCREASES WHICH WE HAVE ALL SEEN IN THE PAST FEW MONTHS WILL NO DOUBT AFFECT OUR LIVES FOR SEVERAL YEARS TO COME. I AM, HOWEVER CONFIDENT THAT YOU, AS CITIZENS OF THE MOST POWERFUL ECONOMIC STATE IN THIS NATION WILL CONTINUE TO MEET THIS CURRENT CHALLENGE. I ONCE AGAIN COMMEND YOU ON YOUR MAGNIFICENT EFFORT AT REDUCING CALIFORNIA'S OIL CONSUMPTION DURING THIS CRISIS PERIOD. AND I THANK YOU FOR YOUR CONTINUED SUPPORT.

GOOD NIGHT.

#0692

To: Y.ALLENA (DOE400)
From: A.GANDARA-CA (DOE468) Posted: Tue 7-June-83 19:44 Sys 64 (20)
Subject: impacts of mud slides on california's petroleum supply system

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the california department of transportation has revised its estimate of mud slide impacts on vehicle routes through the tehachapi mountains. the southbound interstate 5 has been severly blocked and will closed for approximately 7 days. four northbound lanes will be reopened for service within 48 hours. until the southbound lanes are cleared, southbound traffic will use two of the northbound lanes at reduced speeds. no impacts to the distribution of residual fuel are expected.

b. b. blevins
california energy commission

Rest of Scan: READ ALL --- [illegible]

#0705

To: Y.ALLENC (DOE416)
From: J.WEBB-NGA (DOE435) Posted: Wed 8-June-83 16:19 Sys 64 (27)
Subject: REQUEST FOR INFO FROM CALIFORNIA ON IMPLEMENTATION OF OIL TAX

FROM; MARK POPOVICH,NGA
TO; ARTURO GANDARA, CALIFORNIA

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::  THIS IS AN AST-4 TEST MESSAGE IT IS FOR PURPOSES OF THE AST-4 TESTS ONLY
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[illegible]'VE JUST RECEIVED THE RETRANSMISSION OF THE TEXT OF YOUR GOVERNORS [illegible]VISION ADDRESS TO THE PEOPLE OF CALIFNORNIA ON THE CURRENT ENERGY CRISIS. I AM INTERESTED IN RECEIVING ADDITIONAL INFORMATION ON THE IMPOSITION OF THE OIL SEVERENCE TAX..... WHAT IS THE EVEL OF THE TAX? DO YOU HAVE ANY FIGURES ON THE PERCENTAGE OF CALIFORNIA OIL SUBJECT TO THE TAX MIGHT BE CONSUMED OUTSIDE OF THE STATE? WOULD THE TAX APPLY TO OIL CONSUMED OUTSIDE OF THE STATE? . HOW WILL THE INCOME FROM THIS TAX BE USED BY THE STATE? IF A NATIONAL ECONOMIC RESPONSE PACKAGE WAS ENACTED, WOULD CALIFORNIA REPEAL THE SEVERENCE TAX?

I WOULD APPRECIATE ANY INFORMATION YOU MIGHT BE ABLE TO SUPPLY IN RESPONSE TO THESE QUESTIONS.

THANKS.

MARK G. POPOVICH, NGA

To: J.WEBB-NGA (DOE435)
Cc: T.LLENA (DOE400)
From: A.GANDARA-CA (DOE468) Posted: Fri 10-June-83 13:23 Sys 64 (35
Subject: response to nga request on california oil severence tax

0719

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the level of the california severence tax is 5%

50% of the crude oil refined in california is produced in california. in 1981, 12% of total refined product sales for california were exported to other states. gasoline was the largest component of these exports.

the severence tax would apply to all crude oil produced in california.

revenues from the severence tax will be exclusively used to support existing federal and state programs aimed at relieving increased financial hardships to low and fixed income groups.

the severence tax has been implemented as an emergency measure. if the federal government provides substitute revenues earmarked for the same purposes, the need for the california severence tax would be reconsidered.

b. b. blevins
california energy commission

in a may 31 message from the u.s. neso (doe#0592), secretary hodel stated that, "i am pleased at the overwhelming support by oil companies, manufacturers and industrial oil consumers. their combined voluntary offers total 6.5 million metric tons (approximately 45.5 million barrels of oil)." in a may 30 issues of INSIDE ENERGY, an article concerning the ast4 exercise noted that, "u.s. companies offered more than 50 million barrels to meet those supply obligations, although about two-thirds of those offers came from industrial users of oil rather than the oil companies." who are these "mysterious" industrial users that volunteered 33 million barrels of oil to meet u.s. supply obligations? why weren't they mentioned in the u.s. neso message of may 31 (doe#[illegible])? what is the relationship of this non-oil company group to the RCs and NRCs?

on may 3, 1983, doe announced the formation of an interagency working group on the emergency situation. this group was to file a weekly report with the assistant secretary for environmental protection, safety and emergency prepareness. how has this group reacted to developments in the test? is the group continuing to prepare weekly reports for the assistant secretary?

To: Y.ALLEMA (DOE400)
From: A.GANDARA-CA (DOE460) Posted: Sat 11-June-83 0:22 Sys 64 (76)
Subject: california inquiries - package 3

#0722

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PLEASE PROVIDE RESPONSES TO THE FOLLOWING:

1. on may 23 FEMA transmitted a message to doe summarizing its assessment of impacts related to the ast4 disruption. FEMA stated that, "...notabl improvements are expected in most macro-measures in the fourth quarter...the economy is expected to begin an upswing at that time." this statement is contrary to impacts observed subsequent to the 1973 and 1979 oil price shocks. what empirical analysis performed by FEMA supports this conclusion? how do the FEMA results compare with similar assessments presumably performed by omb, the department of commerce and the u.s. treasury? to what degree is the administration emergency response based on the FEMA assessment? has FEMA's assessment changed as a result of the cycle II scenario?

2. to date, all u.s. neso mesages pertaining to the cessation of spr fill have focused on "contract" purchases. on may 26, the u.s. neso stated that, "the spr fill has been substantially curtailed through the invocation of force majeure", and that, "this would result in a 60% reduction in spr fill" (doe#0389). also, in a june 6 message concerning cessation of spr purchases (doe#0661), the u.s. neso noted that, "the purchases for the spr fill are made under long term contracts, therefore the effects of curtailment and cessation are delayed." however, in another june 6 message, doe states that "as of may 1, 1981, the spr contained about 135 million barrels of oil, 3.8 million barrels of which, or 2.8%, were bought under long term contracts...doe bought the remainder of spr oil on the spot market." at no point during the test has doe explicitly stated that it has ceased purchasing spr fill oil from the spot market. according to doe, these purchases composed 97.2% of the spr fill as of may 1, 1981. please clarify your interpretation of contract purchases versus spot market purchases! are spot market purchases continuing? if not, when did the u.s. neso announce that these purchas had been discontinued? if spot market purchases are continuing, what is the significance of secretary hodel's action to cease solicitations for "new contracts"?

The CHAIRMAN. Thank you.

Senator Metzenbaum, I think again my time has expired.

Senator METZENBAUM. Mr. Wendt, in a statement of Mr. Vaughan, he says that the report noted that two fair-sharing type options were identified in AST-4. He says that, one, drawdown of the SPR so that companies would successfully bid on SPR oil would be encouraged to make voluntary offers.

Now that assumes that the oil companies are going to make these voluntary offers, but as a matter of fact Ashland, Exxon, Phillips, Shell, Southern California, and Texaco all stated that they would participate in IEA allocation plan only with a fair-sharing plan in place.

Now GAO also pointed out that 88 percent of the oil stocks made available by oil companies for allocation during the IEA exercise were assured that a so-called fair-sharing plan is in effect.

The foreign countries have indicated that they are concerned that there is no fair-sharing plan in effect. Domestic companies have indicated that they wouldn't participate if there were not a fair-sharing plan in effect.

Mr. Vaughan's testimony says that the only basis on which the program can move is on the assumption that the oil company purchasers would make voluntary offers.

My question to you is assume again that the Straits of Hormuz were closed today. The IEA plan would not go into effect except to be calling upon America to give up 1.3 million barrels of oil a day. The other nations have indicated that they would not participate unless there were a fair-sharing plan in effect. The oil companies have said they wouldn't.

How can we assume that the administration has some program to protect our national interest?

Mr. WENDT. Senator, first of all, I'm not sure that other countries have said they wouldn't participate unless we had a fair-sharing program in effect. It is, as we indicated earlier, an issue that has to be addressed.

We have indicated in our testimony that there are several ways to approach the problem and we are prepared to consider others if they are needed.

One that we didn't mention, Senator, was the option of directing up to 10 percent of the volumes drawn down from the SPR to specific companies if that became necessary.

Senator METZENBAUM. The way I came to the conclusion that the other countries had indicated a concern was not only public statements but your statement that while the United States was not named directly, from its criticism they are focused on what was perceived as, A, the danger of exclusive reliance on price restraint and demand and, B, the lack of commitment to the IEA that such a policy might imply.

Then you go on to say, I assured IEA partners of the continuing United States commitment to the IEA.

I think in all fairness you can assure our IEA partners of the commitment of the administration, but there are some of us in the Congress who think that it is counterproductive or counterworthwhile to our own Nation's best interest.

Mr. **Wendt**. Senator, there was criticism, as I indicated very frankly in my testimony, but criticism is not the same as a refusal to participate.

I understood you to say that other countries had said they would not participate in the system if we did not have a fair-sharing system. To my knowledge, that isn't the case.

In any event, that is not really what we need to address right here. We agree that some kind of a fair sharing—some system that deals with the fair-sharing issue is necessary.

We have tried to indicate a number of ways in which it can be dealt with. We have also indicated that we are prepared to consider other measures if necessary.

I believe it is correct that a number of companies have indicated that they need a fair-sharing system in order to be able to participate in the IEA emergency sharing scheme. We recognize that problem. We are dealing with it.

Senator **Metzenbaum**. How are you dealing with it? I'm worried about the emergency that happens today and when you have such giants as Ashland, Exxon, Phillips, Shell, Southern California, and Texaco all indicating that they won't participate unless there is a fair-sharing plan in place, you don't have a program.

Mr. **Wendt**. Well, I'm not prepared to admit that we're not able to deal with this problem.

Senator **Metzenbaum**. How?

Mr. **Wendt**. It depends on how you define a plan or a program. We have indicated ways to deal with the issue.

Senator **Metzenbaum**. Is there a fair-sharing plan in place?

Mr. **Wendt**. There are various measures available to the administration to deal with the fair-sharing issue, yes.

Senator **Metzenbaum**. What?

Mr. **Wendt**. Well, I've just indicated some of them. Drawing down of the SPR and——

Senator **Metzenbaum**. That doesn't provide for fair share. That only means the highest bidder gets it.

Mr. **Wendt**. It brings more oil onto the market, which is very helpful in encouraging companies to make voluntary offers.

I can understand the point of view of companies who say in advance that they want a fair-sharing system in place.

What would happen in reality is very hard to predict. I think that we have the means available to deal with the problem, but perhaps if circumstances proved that additional means were necessary, we could consider them.

As I indicated again, we have the option of directing up to 10 percent of the volume drawn down from the SPR to specific companies. I think that is a very precise measure that would enable us to deal with this issue.

Mr. **Vaughan**. Senator, if I may comment on this subject.

In the specific case of AST-4, the participating U.S. companies were told we were not going to impose a fair-sharing program in that test. Because we determined that there was some misunderstanding and disagreement about that, twice in writing, we suggested to them that if anyone were not willing to participate, in the absence of a fair-sharing program, withdraw your offers of voluntary sharing.

No offer was withdrawn.

Lastly, there was no fairsharing even contemplated or ever discussed with nonreporting companies and they themselves offered enough oil to more than meet U.S. obligations for the purpose of this test.

Senator METZENBAUM. Mr. Vaughan, are you saying that the companies that I have mentioned have not publicly indicated that they were participating in the IEA allocation plan only with the fair-sharing plan in place?

Are you sharing that that is absolutely what they have said publicly?

Mr. VAUGHAN. I'm stating—let me restate it, Senator.

Senator METZENBAUM. Well, you said that they agreed to participate in the AST-4.

Mr. VAUGHAN. They are——

Senator METZENBAUM. And I am saying to you that they are saying publicly, as I understand it—if I am wrong, I stand corrected, but as I understand, they said publicly that they will not participate in the IEA allocation plan unless there was a fair-sharing plan in place. And we don't have that.

Mr. VAUGHAN. Senator, we do have a fair-sharing capability in place. It is merely a matter of breaking the water, if you desire to do so, and that is the second method I described in my testimony. That is a very simple thing, and it was described in the after action report that we submitted on the play of AST-4.

The CHAIRMAN. Are you referring to the authority under section 251 of EPCA?

Mr. VAUGHAN. I believe that is right, Senator.

The CHAIRMAN. Now, the Department of Justice, your own Counsel, and others have said you don't have that authority. That section 251 does not apply except to fair-sharing in international not domestic, terms.

Mr. VAUGHAN. I am speaking of international. I believe the question was directed to international, Senator. If I have misunderstood, then, I am very much speaking in error.

The CHAIRMAN. I thought Senator Metzenbaum was referring to whether or not there was a fair-sharing program domestically that would deal with the question of the willingness of the companies to deal in fair-sharing internationally, and the EPCA authority, as I understand it, most of the legal authorities looking at it agree that it applies only to fair-sharing in the international arena, not domestically.

Mr. VAUGHAN. I am unaware of this being a serious discussion domestically, Senator. There are obviously some companies that would love to have their market shares protected domestically.

The CHAIRMAN. I am talking about the authority of EPCA. My understanding is that the authority under EPCA does not extend to domestic fair-sharing program.

Mr. VAUGHAN. I believe you are correct, Senator, on that point, and I am certainly not testifying that it is applicable domestically. I will verify that point and respond for the record.

[The information follows:]

STATEMENT OF ADMINISTRATION VIEWS

Testimony was given at the Committee's July 20, 1981, hearing on extending section 252 of the Energy Policy and Conservation Act (EPCA), that in the view of the Administration, section 251 of the EPCA provides adequate legal authority for a domestic fair sharing program in support of U.S. obligations under the Agreement on an International Energy Program (IEP). Following the hearing, the legal opinion of the General Counsel of the Department of Energy, concurred in by the Department of Justice, was submitted for the hearing record. The opinion concluded as follows:

> It is clear that section 251 would permit a Presidential finding that it is "necessary" to impose a mandatory limited domestic allocation system in order to secure the swift and sure cooperation of oil companies in fulfilling our international obligations. It would be inconsistent with the contemplated operation of the IEP system and with the broad language of section 251 to limit the authority in that section to mandatory international allocation orders; the IEP itself does not make such orders the sole means by which member nations may fulfill their obligations and the IEA's plans for dealing with severe disruptions place primary reliance on voluntary company participation facilitated, if necessary, by domestic fair sharing procedures.

See *Hearings on Extension of the Expiration Date of Section 252 of the Energy Policy and Conservation Act*, 97th Cong., 1st Sess. 55-62 (1981).

This view was reaffirmed in the November 15, 1982, Memorandum of Law submitted to Congress by the Office of Legal Counsel of the Department of Justice, as required by section 3 of the Energy Emergency Preparedness Act of 1982, Pub. L. 97-229:

> Section 251 specifically authorizes the President to direct oil companies "to take such action as he determines to be necessary" to meet the international allocation obligations of the United States under the IEP.... Consistent with this language and the arguable breadth of the IEP Agreement, the President could find that a limited domestic "fair sharing" allocation program would be necessary in order for the United States to meet its IEP allocation obligations through the voluntary cooperation of U.S. oil companies, because such cooperation could well depend on assurances to the participating companies that they would not suffer competitive losses. A presidential determination would be accorded substantial deference by the courts. (pp. 16-17)

This remains the view of the Administration.

Senator **Metzenbaum**. Now, Mr. Vaughan, before you stated to me that you didn't know about Mr. Hodel's statement concerning the use of this strategic petroleum reserve with respect to prices. Let me direct your attention to the Washington Post—I am not sure of the date—I'll get it for you.

It is October—Wednesday, October 5.

> In the event of the Persian Gulf oil crisis, the Reagan Administration probably would not sell off crude oil from the Strategic Petroleum Reserve simply to keep a nervous market from sending oil prices soaring, Energy Secretary Donald Hodel indicated yesterday.

Now, that is directly contrary to what you have indicated. I can read on, if you want. But certainly you have said that there would be a sale in order to maintain allocation and prices.

Now, it would appear to the contrary.

Mr. **Vaughan**. Senator, I am familiar with what the Secretary said. I believe he said that the prime purpose of the SPR is as a supply supplement, and I think, in answer to your question, I pointed out that when you supplement supply in a market that is fungible, you affect price.

Now, we are talking about what your motivation is, at the time, and I don't see that there is much distinction here, frankly. I do not believe that the Secretary of Energy has ruled out—and I will, if necessary, consult with him following this hearing and clarify that point for you, the possibility that the motivation might be to affect prices.

The **Chairman**. Would the Senator yield on that point?

And I thank the Senator for yielding. I don't mean to interrupt his train of thought or questions at all.

Secretary Vaughan, on the bottom of page 7 and the top of page 8 of your statement, you say it has never been the administration's intention to activate the NDER units for purely regional or local emergencies, such as snowstorms, local distribution outages, or local strikes.

I understand that, but I think that your necessity, or your feeling that it was necessary, to say that would indicate that you don't quite understand where we are coming from either. I don't believe anything has ever been said by this committee, or by the members of the committee, or in the bill that was vetoed by the President, indicated that it was our intention that you intervene in the market for those kinds of contingencies.

I mention that at this time, simply because I think it bears upon whether or not we understand each other. While I wouldn't look to the Washington Post as the best source of information as to what this administration's policy is, or what its thinking may be, it does certainly indicate that there is some misunderstanding or some doubt about what our policy is.

If I understand what Secretary Hodel was saying at that time, it is in the context of what you are saying here, just as it was, is in our emergency preparedness stockpiles of critical materials, the Congress has said, you cannot use stockpiles simply to affect price or the availability of the marketplace. They are an emergency response to deal with the security of this country.

And if I read together what you are saying here, and what Secretary Hodel is reported there as having said, that is the thrust or the context of his remarks.

Am I in error, or am I correct in that?

Mr. **Vaughan**. I think you are quite correct, Senator. I think the Secretary sees a primary purpose of this reserve, and a primary use, is as a supply supplement. We certainly recognize that when one supplements supply, one affects prices, and we certainly have the authority to so do.

I think what the Secretary meant, based on a in the number of conversations I have had with him on the subject, is that the SPR is not designed, to knock prices down when the prices go up a dollar a barrel.

Our concern, if we have any truly—is for the protracted shortage where one of the impacts is price increases which do all these economic harms that all of us have been talking about.

Senator **Metzenbaum**. Mr. Vaughan, it would seem to me that you are sort of dancing around at what the Secretary said, because you can talk about supply, and pretend that it is on the opposite side of the street from price; but the facts are that supply is very much relevant to the question of price.

Mr. **Vaughan**. I agree with you totally, and that is the point that I am trying to make.

Senator **Metzenbaum**. Well, but the point is that you had indicated earlier that the SPR would be to help keep down the prices. When I asked you that question, you said one of the things that we would be doing is that.

And Secretary Hodel said, as where the oil might be sold off and the strategic petroleum reserve to prevent a fly-up in prices—and you essentially would use it to replace loss supply.

Hodel said that drawing out of the strategic petroleum reserve to change the price of oil was not its intended purpose; it was intended to be for emergencies; and I think we have to keep that in mind.

Now, frankly, the question of $98 oil is a matter of—in the minds of some of us—a national emergency, and it is the question—certainly, it is question of the only reason the price goes to $98 is because there is a shortage of supply.

And yet, you had said earlier that it would not be used with respect to the matter of pricing.

Mr. **Vaughan**. Again, sir, I think we are maybe haggling over a distinction without much difference here. I do believe that, as I tried to point out, price and supply are interlinked and that the Secretary, as far as I know, has certainly never meant to say that the administration rules out trying to protect the Nation against $98 a barrel oil. But it is a distinction, it seems to me, sir, without much difference, because if you use the SPR as a supply supplement, it must affect price.

Senator **Metzenbaum**. Will the oil companies take oil to other countries, and sell it to them at $40 to $50 a barrel, even with the IEA if the U.S. price is $98 a barrel?

And isn't that the problem that Mr. Wendt indicated the other nations are concerned about?

Mr. **Vaughan**. In general, it is not likely that anyone would sell for $50 what he can sell for $98. That is a truism, Senator.

And I would point out that when the United States calculated mechanically the price of oil at $98 in AST-4, that was an estimate of the world market clearing price of oil, as it arrived in this country. The discrepancy in price could not exist as it is described in your hypothetical situation.

Senator **Metzenbaum**. There are 20 other countries that participate with us in the IEA, which of them have mandatory conservation measures, mandatory controls, mandatory allocation procedures, as a contradistinction to the United States?

Mr. **Vaughan**. I cannot list them here for you, sir.

I will say simply that most of them have the authority for mandatory demand restraints. I will be glad to furnish you with a detailed copy of exactly what they do have.

Senator **Metzenbaum**. So, they do, and we do not.

Mr. **Vaughan**. Yes, sir, they do—many of them do, and we do not, by choice.

The **Chairman**. Could you include in that listing also the availability or the presence of price control mechanisms?

Mr. **Vaughan**. Yes, sir, but I think perhaps the more useful list would be to describe what they do, as a demand restraint of a control measure; and in all of these particulars, we will be glad to furnish that.

[The information follows:]

Petroleum Product Pricing and Allocation Policies in IEA Countries

Attached is a review of petroleum product pricing and allocation policies in IEA countries other than the United States. Luxembourg, which generally follows Belgian practices, is excluded from this list.

IEA COUNTRIES POLICIES ON PRICING AND ALLOCATION - BUSINESS AS USUAL AND EMERGENCY PERIODS

Office of International Emergency Measures
Assistant Secretary for International Affairs
U.S. Department of Energy

10/21/83

SUMMARY

- A majority (11) of the International Energy Agency (IEA) countries use price controls, on a BAU (business as usual) basis. In addition, 2 countries (Turkey and Greece) allocate supplies on a BAU basis. However, the total volume of oil over which price controls are exercised is only 20 percent (6.5 MMB/D) of total 1982 IEA demand of 32.5 MMB/D. The United Kingdom, Federal Republic of Germany, Japan, and the United States account for 74 percent (24.1 MMB/D) of total 1982 IEA demand, and prices are not controlled in these economies.

- While most European countries control the retail price of gasoline and heating oil in BAU and emergency periods, historically, governments have increased prices, with a lag, so domestic prices closely follow world prices. In addition, very high levels of tax are imposed in all other IEA countries except Canada, making the price to consumers at least twice the U.S. level.

- Among IEA countries, only the United States lacks either specific plans or the intention to implement specific plans for allocation and rationing. However, there is nothing in the International Energy Program (IEP) which, per se, requires IEA countries to have such plans.

- Throughout the following review, "Emergency" is defined as that level of reduction in available oil supplies sufficient to trigger the IEA Sharing System. Note, however, that simply because this 7 percent reduction threshold is reached, the system is not necessarily triggered. Over the 1979/80 period, the IEA experienced technical trigger levels without activating the system. This is because consumption was declining rapidly, relative to the base period used in the calculation. Furthermore, informal sharing arrangements may be attempted, as they were in 1979 and 1980 with respect to Sweden and Turkey. These arrangements have been successful.

Please direct inquiries to either Eric Forman (252-5191) or David Guthrie (252-1885).

AUSTRALIA

BAU

- While, technically, prices are controlled, refiners pay prices for domestically produced crude oils on a par with world levels.
- Except in times of very tight supplies (1979/81), allocation is not done.

Emergency

- The first measures would be limited to allocation by oil companies guided by the government, to customers on a fixed percent reduction basis, coupled with ad hoc measures restraining retail demand for gasoline:
  - odd/even days
  - weekend closings
  - reduced sales hours
  - maximum/minimum purchases
  - carless days
- If the shortage continues, plans exist for the introduction of rationing to allocate refined products.
- Rationing would be based on assigned user priorities with lowest priority to private motorists, highest to essential services.
- The government also contemplates a reduction in lead content specifications, octane ratings, and fuel volatility specifications to increase refinery output.

Experience with Programs

- Along with the other IEA countries in 1979 and 1980, Australia attempted to reduce demand and imports. Programs involved fuel switching and increased indigenous production. They have not so far used the demand restraint programs.

AUSTRIA

BAU

- Product prices are controlled but are kept at levels in line with neighboring IEA countries.

- Products regulated are gasoline and heating oil. Other petroleum product prices are not regulated.

Emergency

- Emergency demand management is controlled almost exclusively by the government. This in contrast with many countries who require industry to carry out these programs.

- Gasoline and home heating oil would be rationed.

- It is questionable whether the number of staff devoted to emergency management would be sufficient. Also, most of the programs would require a lead-time of approximately 3 months to implement.

Experience with Programs

- During the 1979/81 price increases, Austrian domestic prices were permitted to increase in concert with world prices.

- Not since World War II, has Austraia employed petroleum rationing.

- An additional problem is Austria's land-locked position, where it is entirely dependent on cross-border imports from Italy and West Germany. In a previous IEA Allocation System Test (#3), the Italians banned the export of finished petrol products. Should they do this in a real emergency, shortage could result in Eastern Austria.

BELGIUM

BAU

- Belgium normally controls retail product prices, but also imposes a high level of tax so that the pump price is usually double U.S. levels.

Emergency

- Due to several changes of government in recent years, it has proved difficult to arrive at a lasting concensus on emergency issues.
- Royal/Ministerial Orders are needed to obtain a legal basis for specific measures; because of the frequency of governments, these may be difficult to obtain.
- Plans for the rationing of gasoline are the most highly developed so far, but are viewed as a last resort measure.
- Plans for a better allocation system are underway with the first priority being the establishment of user priorities.
- A significant problem in any Belgian demand restraint system is data. Historically, Belgian data submitted to the IEA has been late and of questionable accuracy. This has been true not only of the Questionnaire B data submitted in a crisis, but of the quarterly submission as well, which usually lags the current period by 70-90 days.

Experience with Programs

- A simplified home heating oil allocation system was used in 1979/80. Consumers received 80% of their 1978 consumption . Industrial fuel oil was also allocated along the same lines.

CANADA

BAU

- Although Canada is not allocating fuel supplies, it does use domestic price controls which have tended to make its retail prices below the rest of the IEA countries.

Emergency

- Crude allocation is the initial response. The government says it can be implemented within 7 days.
- A Canada-wide linear programming model will be used to optimize refinery output. Every refinery's product slate is modelled in the LP, thus, a change in crude quality can be optimized.
- Refined products will initially be allocated with a lead time of 60 days to full implementation.
- Rationing will be invoked 6 months after allocation only if allocation does not seem to be effective or if the shortfall reaches 20%.
- The Canadian NESO (National Emergency Sharing Organization) is staffed with members from industry, provincial and federal government.
- Potential problems may arise due to the unique relationship of the provinces to the Federal government.

Experience with Programs

- Being a net exporter of crude oil, the country did not feel the pinch in supplies in 1973/74 or 1979/80.
- Over the 1979/80 period, persuasion, fuel-switching and increased indigenous production were the programs used to achieve the IEA targets for the reduction, by 5 percent, of consumption and imports of those years.

DENMARK

BAU

- Market prices are used during normal periods; high taxes are also imposed.

Emergency

- Diesel fuel and heating oil are subject to allocation. Rationing may be imposed on heating oil, if the crisis becomes severe enough.

- According to the IEA, the average use of cars is very low. Thus, while a rationing system for gasoline is under study (July 1983) its usefulness is questionnable.

- LPG is also allocated in emergencies when used for heating and gas works purposes.

- Priority industries for allocation purposes have not been defined, and the Danish system is geared only toward coping with import crises, but not internal supply problems.

Experience with Programs

- During the 1979/80 period, reliance was placed on the market mechanism, increased taxes on products, and lowered speed limits.

WEST GERMANY

BAU

- Germany does not intervene in the market during normal periods.

Emergency

- Gasoline and diesel oil rationing and home heating oil allocation are the principal emergency measures.

- The FRG estimates the time lag for implementation of allocation at 2 months, rationing at 4 months.

- Public information campaigns are also used to encourage reduced consumption.

Experience with Programs

- Compulsory orders and public information were used in the 1973/74 oil crisis.

- In 1979/80, as a response to the IEA programs to reduce consumption and imports of those years, persuasion measures were used but with only limited success.

GREECE

BAU

- Supply is managed entirely by the government. Oil is either bought directly by the government from producing countries or imported under license from the government.
- Oil companies buy from the state at uniform prices and sell to the consumer at controlled prices.
- Retailers get products allocated to them according to their sales forecasts.

Emergency

- Rudimentary rationing plans exist only for gasoline. Other products, except lube oils, aviation gasoline, and ships bunkers, are allocated.
- Like The Netherlands, Greece has a large market for ships bunkers, and has been encouraged to develop a demand restraint program for them.
- The government provides a strong incentive to build stocks when prices go up by not taxing the increase in value.

Experience with Programs

- As Greece controls prices and allocates on a BAU basis, the only program they have not had experience with is rationing. Seemingly, the only difference between BAU and an emergency is the reduction in volumes to be allocated.

IRELAND

BAU

- Product prices are tightly controlled and high taxes are levied on retail sales.

- Until recently, Ireland had to import all its petroleum requirements as finished products. Its single refinery was not operating due to lack of sufficient return to the operator, Exxon. Potential discoveries in the Irish Sea may lead to less dependency on imports.

Emergency

- Gasoline and diesel are subject to a rationing system based on vehicle registration. As many car owners do not register their cars, it is questionnable how effectively the system will function.

- A shortfall of up to 14% will be handled by drawing stocks, conservation publicity, and statutory measures, including:

  - minimum sales;
  - compulsory opening hours for retail suppliers;
  - lower speed limits;
  - odd/even day gasoline sales; and
  - bans on weekend driving.

- Peat will be substituted for heating oil in homes where such substitution is appropriate. When this is not so, allocation of heating oil will take place.

Experience with Programs

- In the 1979/80 period, gasoline, diesel, and heating oil were allocated to essential sectors of the economy. A variety of persuasion measures, tax incentives, and compulsory orders were also used.

ITALY

BAU

- Price controls are in effect and likely to stay there, mostly for political reasons. Nevertheless, a high level of taxation is imposed on retail prices which (depending upon the exchange rate) yields a price at least twice the U.S. domestic average. Allocation is not used.

Emergency

- Gasoline and diesel oil will be rationed but not allocated.
- Home heating oil will be allocated on a regional basis, based upon climatic conditions.
- Price increases for gasoline by raising the tax rate are to be the first measures taken to restrain demand.

Experience with Programs

- Rationing was just short of being used in the Suez crisis.
- In 1973/74, compulsory orders were used, consisting of lowered speed limits, driving bans on Sundays and holidays and carpooling.

JAPAN

- Government controls energy usage by using social pressure, not by compulsory orders, although legislative authority exists to promulgate such orders.
- Japan does not control prices, nor allocate products. However, oil is not imported into Japan without conferring with MITI, the Ministry of International Trade and Industry.
- The Petroleum Industry Law of 1962 aims to secure a stable supply of petroleum at "moderate" prices by adjusting the level of business activity of the petroleum industry.
- When Japan negotiates contracts for crude oil supplies, the contracting team will usually include a member from MITI, from the foreign ministry, and from the company actually attempting to acquire the oil.
- MITI provides administrative guidance to all phases of energy use. Because of this, no real crash emergency plans have been made public, if they even exist.
- The uniqueness of the Japanese model stems from the people's acceptance of and trust in the government's stated goals to reduce imports without greatly reducing economic activity.
- By using persuasion and social pressure, Japan was successful, during the 1979/80 period, in reducing its level of oil imports according to the IEA formula of those years.

Experience with Programs

- Given the nature of the Japanese "system", this is impossible to assess.

THE NETHERLANDS

BAU

- Although Holland used price controls from 1979 to 1981, it has discontinued the practice. Allocation is not now in use.

Emergency

- Gasoline and diesel are subject to limited retail station openings, restrictions on volumes purchased, lowered speed limits, and in a severe emergency, rationing.

- A reduction of lead sulfur content and octane specifications will be used to increase refinery product yield.

- Other products except ships bunkers are subject to allocation.

- Ships bunkers have no demand restraint system. Holland is a major bunkering country for European shippers and the Dutch have frequently been encouraged by the IEA to develop a system for this purpose.

- User priorities will be established to ensure that essential services continue to be provided. Public transportation is a service which will receive more oil than in BAU periods.

- Refineries will be ordered to produce a disproportionately higher percentage of light products, e.g., gasoline and naphtha (for use in the petrochemical industry).

Experience with Programs

- Planning functions, examining stock management, and specific demand restraint programs were activated in 1973/74.

- Voluntary delivery reductions and persuasion were effectively used in the 1979/1980 period.

NEW ZEALAND

BAU

- Irrespective of pricing policies, New Zealand's position at the very end of the Pacific supply chain have caused difficulties in obtaining supplies.

- Neither price nor allocation controls are currently in place, although even marginally tight supply periods can cause one or the other to come into effect.

Emergency

- One of the broadest and most thorough of any IEA country's programs, New Zealand can directly control virtually every phase of its energy supply.

- One very large crude carrier (250,000 tons) can reprovision the entire country for one month.

- A gasoline and diesel oil rationing system exists which uses a white market for trading excess coupons coupled with 5 classes of consumer priority.

- All fuels have in-place allocation systems developed in cooperation with industry and traders.

- The estimated costs of operating these systems are high. The minimum lead time for implementation of rationing is 3-4 months.

- Rationing by price has been explicity rejected.

Experience with Programs

- Extensive experience was gained with all programs except rationing over 1979/80. The system was uniformly successful in attaining goals set by the government.

- Voluntary measures were found to be less successful than compulsory ones.

NORWAY

BAU

- Retail petroleum prices are controlled. Being self-sufficient in oil, Norway also imposes taxes to discourage demand.

Emergency

- Norway occupies a unique position with respect to the IEA. At its option, it can choose whether or not to participate in reallocation.
- Because of this position, Norway has not pursued the development of demand restraint programs with as much vigor as other IEA countries.
- Nonetheless, rationing and allocation programs have been under consideration for several years. Compulsory orders are available to target specific end-use groups.

Experience with Programs

None.

PORTUGAL

BAU

- Portugal was one of the three countries originally targetted by the 1973/74 OPEC embargo, the other two being The Netherlands and the United States.
- Prices of the major products are fixed by the Government, and are among the highest in Europe.
- Low per capital energy consumption coupled with relatively few privately owned automobiles, means gasoline use reduction programs have little effect.
- Refining is exclusively a state enterprise. Retail sales are mostly handled by the Government with some marketing from the Majors.

Emergency

- Allocation is the major method for restraining demand. Programs exist for all major product categories.
- Energy-intensive sectors of the economy will be required to give up disproportionately more energy in an emergency.

Experience with Programs

- Other than persuasion measures, none.

SPAIN

BAU

- Prices for petroleum products are tightly controlled. Taxes are also imposed on retail sales so as to make the effective pump price double the U.S. level.

Emergency

- A rationing program exists but the Government does not anticipate using it due to the long (300 days estimated) lead time which would be required to implement it.
- Allocation by product, and compulsory orders are the preferred methods for dealing with emergencies.
- The timing for implementation of allocation programs is expected to be short - virtually all oil products are distributed by the state.
- Noticeably absent from any demand restraint system is diesel oil. The reasons for this absence are unknown.

Experience with Programs

- During the 1973/74 supply shortage, Spain had ample supplies of petroleum.
- In 1979/80, oil prices were raised significantly, heating oil and aviation fuel was successfully allocated. Allocation was for conservation rather than shortage reasons.

SWEDEN

BAU

- Prices are controlled for products. This situation coupled with an abnormally severe winter which froze access to refineries resulted in an acute shortage in 1979 prompting Sweden to formally request an IEA selective trigger. It is the only IEA country to have formally done so.

- The situation was resolved with ad hoc measures which increased supplies, demand restraint measures which worked, and a change in the calculation of Base Period Final Consumption (the denominator in the IEA trigger) which permits seasonality to be taken into account, only in the case of Sweden.

- Unlike most other IEA countries with price controls, price increases are not automatically passed through.

Emergency

- Some form of demand restraint exists for virtually all types of petroleum products.

- Gasoline is rationed, based on user priorities. The system is expected to be operational within 5 weeks.

- Heating oil will be allocated according to a formula which takes into account the most recent 2-year period for calculating rights.

- Industrial use will probably be determined by a priority-based allocation system.

Experience with Programs

- As noted above, in 1979/80, Sweden used demand restraint measures to effectively control a temporary shortage caused by weather and low prices.

- In 1973/74, the Government rationed gasoline and diesel.

SWITZERLAND

BAU

- Market forces determine the optimal allocation of resources.

Emergency

- All areas of supply have emergency systems for rationing and allocation, tested and in place. Measures are altered as circumstances change; thus, after the 1973/74 embargo, a major effort was undertaken to modify procedures for the handling of a petroleum supply emergency.
- All products (including petrochemical feedstocks) are covered by these measures.
- All fuels are subject to allocation. Gasoline, aviation gasoline, diesel fuel, and bunker fuels can be rationed, in addition.
- Compulsory orders (such as restrictions on time-of-day usage) are in place for the major fuels, plus specialty products and feedstocks.
- The time for implementations of rationing is known to be 2 months. Allocation can be accomplished within 2-3 weeks.
- In spite of the changing complexity of a crisis, allocation must be used for at least 1 month.

Experience with Programs

- Switzerland tests its internal emergency systems periodically.
- In addition, real experience was gained with allocation and rationing in World War II, and to a lesser extent in 1973/74.

TURKEY

BAU

- Price and allocation controls have been in effect in Turkey for years. The country lacks sufficient exports to be able to pay for imported oil, so goods are exchanged for oil from neighboring countries (Iraq).
- During the 1979/81 period, supply shortages were acute, although the situation has eased somewhat. At that time, rationing was done by long waiting lines, and allocation seemed to prefer the industrialized areas and ignored the industries capable of earning foreign exchange (coal).

Emergency

- Programs currently in use are virtually indistinguishable from emergency periods except in the degree of the shortfall.
- Although allocation and rationing exist as government policy, the "system" has been characterized as "everybody to fight for his own supplies."
- The lead time for a fully effective allocation and rationing system is estimated to be 12-18 months.

Experience with Programs

- Constant, and usually ineffective.

UNITED KINGDOM

BAU

- Market forces determine the retail prices of refined petroleum products. British National Oil Company (BNOC - a nationally owned company) is responsible for North Sea production, but its prices track world crude oil prices, with BNOC acting as a marketing agent.

Emergency

- The system is based on 3 stages:
  1. Below 5% shortfall - fuel switching, allocation to public buildings and persuasion.
  2. 5%-10% shortfall - industries voluntarily allocate between 5%-7%, and mandatory above 7%.
  3. Shortfalls above 10% - allocation and rationing of diesel and gasoline.
- Rationing plans exist only for diesel and gasoline.
- Oil companies handle allocation to industry directly.
- Pricing has not been ruled out as an emergency demand restraint measure.

Experience with Programs

- In 1979, the oil industry operated allocation systems, which limited consumers to the previous year's level of consumption.
- In 1980, persuasion was used, with success.

Senator **Metzenbaum**. Mr. Wendt, do you have anything further to say as to why our Nation ought to be in the IEA. I would be pleased to hear it from you at this moment, because I am frank to say that I have only heard some generalities and I get the idea at this moment that our participation in the IEA will not—there is a real question as to whether it will ever become a reality without the participation of the major oil companies, there being absent a fair-share plan. I am just wondering whether we ought to drop out of the IEA entirely and work out individual arrangements with those countries that are in need of oil, should there be a shortage.

Mr. **Wendt**. Senator——

Senator **Metzenbaum**. We could then make the decisions on our own, and not have somebody else make it for us.

Mr. **Wendt**. Senator, I am glad you asked that question. I do think that I covered it in my testimony submitted for the record rather thoroughly, but perhaps there are a few additional comments that I could make right now.

When the IEA was set up—and I would note here that this was an American initiative—we thought that this was a very useful exercise in international solidarity, not unlike a number of other such exercises we have engaged in very successfully over the years.

Senator **Metzenbaum**. This was to be the consumers' cartel.

Mr. **Wendt**. No, sir, it was not to be a consumers' cartel, but it was an effort to enable all consuming countries to concert their policies, to coordinate their efforts to deal with the major effects of a supply disruption.

I indicated the importance of that particular feature of the IEA in my testimony, but let me just say this: If we didn't have the IEA, I dare say we would have to look for something else to take its place, Senator.

You could simply leave everything to individual countries. If you did that, I think you would have competitive scrambling for every drop of oil on the spot market such that it would make the $98 price look cheap.

In fact, the DOE simulations that led to the $98 price also showed that in the absence of the IEA emergency sharing mechanism, the price would have reached $133 a barrel; so I think, Senator, that our participation in IEA has not only very clear-cut benefits in terms of international solidarity, but it really is also important to our national security.

I think the fact that we can sit down with the other 20 countries in the IEA and try to bring some kind of order out of the chaos that would otherwise prevail is a very important benefit to the people of the United States, and very important to our national security.

The **Chairman**. I have just a couple of other questions for this panel.

If I understand the concerns that many have expressed, and what Senator Metzenbaum has been dealing with, with respect to price responses and the use of SPR they may be summarized in two policy choices:

Secretary Wendt, your statement refers to the competitive panic buying that can lead to exaggerated price rises. I assume that what we are talking about is a price response as a result of SPR use, and while its use is not intended to affect an incremental increase of, say, a dollar or a dollar and a half a barrel, it would be intended to blunt that kind of price increases, in a panic-buying situation.

The spot market always results when the opportunities for a gain are there, and when the fear of shortage is there.

The other side of that, and I think a matter of concern to a great many people, not just the Senator from Long Island, is when will the administration intervene, early or late?

There is perception on the part of many that U.S. policy would say, intervene late, that the price would rise to some extent before this administration would react. So, we are not talking really about whether or not we are dealing with an incremental price change, or whether we are failing to deal with panic buying, but we are talking of when in the cycle do we make a judgment that the price movement is apt to be disruptive enough to lead us to intervene.

Most of the statements that come from the administration lead people to believe that intervention would be on the late side rather than on the early side.

Secretary Vaughan, would you comment?

Mr. VAUGHAN. Yes, sir. I think a couple of things have to be considered here. One of the things that is absolutely necessary in this administration's view of emergency response, particularly since we do not have any artificial demand restraints, is that the prices must rise some in order to dampen demand. Certainly one of our obligations under IEA is to allow to try to dampen our demand to meet our supply right under IEA, because if we fail to do so we have the other option of furnishing it in oil.

However, this will be a judgment call at the time. Obviously, it will be a complex call. I think it is fair to say, however, and that is why I have responded to your colleague rather vigorously about the Secretary's remarks, because if anything, one thing Secretary Hodel has done in this area is to focus our thinking much more aggressively on early-on use of SPR. It is kind of ironic that the Secretary's remarks would be misinterpreted when reported.

I think it is absolutely the case. And while that does not say we are locked in place to do that, it certainly says that we have focused a lot of attention on it, and we would expect to continue to do that.

So, it is a judgment call at the time, with the specific situation evaluated, and I think we will never change that situation; nor do I think we should.

The CHAIRMAN. If I could focus on a couple of other areas for just a moment.

One is that earlier the administration said that they would utilize the procedures and the methods of the executive manpower reserve. Since that statement was made, various people have analyzed the likelihood of being able to do so and the likelihood of people being able to come forward. I think the conclusion has been that, at best, the authority to do that is ambiguous; and at worst, the people that would be involved clearly would refuse to be involved because of the antitrust and conflict of interest considerations.

Is it your judgment at this time, Secretary Vaughan, that we need to have the kind of protections that are afforded by S. 1678 to make certain that the executive manpower reserve could be used in the event of an emergency?

Mr. **Vaughan**. Absolutely, Senator. I say that both as an official of the administration, and also in my own judgment as a former corporate counsel—I can't imagine a corporate counsel permitting corporate employees to participate in such voluntary arrangements or in the national executive reserves or their own private counsel allowing that participation in any meaningful way without appropriate protections.

And I think appropriate legislative protection is absolutely essential to the functioning of these reserves. I would point out what your legislation would do is allow us to have domestically the same protection we have in previous legislation granted ourselves for international purposes.

I think we ought at least be fair with ourselves.

The **Chairman**. During our hearing in May of last year, on an emergency preparedness bill, S. 2232, the witness for the Justice Department pointed out that since the establishment of the IEA, the Justice Department, had continuously monitored oil company participation in IEA activities.

The witness stated that the Department had found no adverse impact on competition resulting from industry participation in the IEA.

I would like to know, if, in your opinion, that conclusion, is still accurate. Is it still the case that the Justice Department monitoring has revealed no antitrust violations or anticompetitive efforts since that period, and particularly during the recent test of IEA allocation system.

Mr. **Vaughan**. I believe that is absolutely correct, Senator, and I believe that it is not only the Department of Justice monitoring, but there is also the same type of continuous Federal Trade Commission monitoring, and I do not believe that there has been any problem with competition identified since we have been in this arrangement.

The **Chairman**. Senator Metzenbaum.

Senator **Metzenbaum**. Mr. Chairman. It is my understanding that the Justice Department was invited to participate in these hearings, and they declined. Are they going to be asked to come back?

The **Chairman**. We are certainly going to find out why they declined and see if we might be able to get the benefit of their advice, formally or informally, by whatever means is necessary.

Senator **Metzenbaum**. I think that their testimony is important.

Mr. Vaughan, you talked at one point about having some body composed of public and private members—what is the name of that, CBRX or something? I couldn't find it in your notes.

What is it?

Mr. **Vaughan**. The national defense executive reserve, I believe it was.

Senator **Metzenbaum**. No, it is in connection with this SPR test.

Mr. **Vaughan**. Oh, in direx-B, we empaneled a public private assessment team, and it is the first time that we had such an independent assessment activity. We put ourselves in the fish bowl, and we think we benefited from being in the fish bowl.

Senator **Metzenbaum**. I never heard it before. Would you tell me who the public members were?

Mr. **Vaughan**. I can furnish them for the record, yes.

[The information follows:]

The DIREX-B Assessment Team was composed of representatives of Federal agencies supported by outside consultants.

Management and Decisionmaking Activities

Charles Ebbecke (Team Leader)
Office of Nuclear Energy (DOE)

Albert Linden
Energy Information Agency (DOE)

Stephen T. Minihan
Office of Policy Analysis (DOE)

Nicholas Timenes
Office of Policy Analysis (DOI)

Josephine Colbertson
Office of Policy Analysis (DOI)

Consultants

Milton Copulus
Economic Specialist

Edward Krapels
Energy/Economic Specialist

Gordon Weil
Energy Supply/Demand Specialist

John Ricca
Energy Demand Specialist

SPR Sales and Operations Activities

Capt. Myron Smith (Team Leader)
Office of Naval Petroleum Reserves (DOE)

Thomas Newkirk
Office of General Counsel (DOE)

Devers P. Weaver
Office of Procurement (DOE)

Thomas Neufer
Defense Fuel Supply Center (DOD)

Consultants

Robert Yancy
Petroleum Supply Specialist

James McGarvey
Petroleum Supply Specialist

Ray Whitson
Petroleum Distribution Specialist

Assessment Coordinator

James Caverly
Office of Energy Emergencies (DOE)

Senator **Metzenbaum**. All right.

Mr. Wendt, you left the impression that absent the IEA's that the price would be $133 a barrel, but I now have in my hand the report from the Department of Energy of Eric Foreman to—oh, I guess it comes from the Department of Energy set-asides, and that seems to come to a different conclusion. At least, I think, it indicates that that is only half the story, because what they are saying is that the oil price, if the seasonal stock build were to take place, and no other price-induced demand restraint measures were imposed, the oil price would be needed to clear the full 8 million barrels a day shortfall—it would be $133 a barrel.

Aren't they actually saying that without the demand restraints imposed by the other IEA nations, the price would go to $133 and you are only referring to the IEA of value as being the means of causing them to want to put the demand restraints on?

It seems to me that every nation in the world, if they had any brains, would want to have demand restraints, would want to be consuming their energy resources at the present time. And am I not correct that the demand restraint of the other nations which you suggest is imposed or comes about by reason of their participation in the IEA?

Mr. **Wendt**. Senator, I don't have the report you are referring to. I was trying to make a general point, which is that if we did not have the emergency sharing scheme, if you use the same simulation that was used that led to the $98 price in the AST-4 exercise, the results give you a price of $133.

Now, this is just a simulation.

Senator **Metzenbaum**. I don't think that is right, Mr. Wendt. I think that assumes that there are no demand restraints being exercised by the 20 other nations, and I think if you read the language, you will find it.

And I am saying to you that I think that in all likelihood that the other nations would continue to use those demand restraints just in order to consume their own energy resources, and that the IEA does not cause that to come into being.

Mr. **Wendt**. Well, Senator, it is very hard to draw that conclusion. The IEA exists. The international energy program imposes on the member states a demand restraint obligation—I think it is a matter of pure conjecture as to whether or not you get the same results in the absence of the IEA.

I think there has to be a presumption that because 21 nations have entered into this agreement and accepted the obligations that it imposes, that those obligations do, in fact, have a real impact, and that was——

Senator **Metzenbaum**. What demand restraints imposed by the IEA?

Mr. **Wendt**. Well, it is written right in the international energy program the measures that have to be taken under the general rubric of demand restraint.

Senator **Metzenbaum**. They are not, Mr. Wendt, unless I am totally wrong. There are none because we don't have any of those, and when—I remember when I attended the meeting that it was put on a voluntary basis that each nation would cut their consumption 5 percent. I don't believe that there is any mandatory order coming out of the headquarters of the IEA, putting the demand restraint provision on our Nation, because we don't have any.

Mr. WENDT. Well, Senator, chapter II of the IEP entitled "Demand Restraint" provides that every participating country shall at all times have ready a program of contingent oil demand restraint measures, enabling it to reduce its rate of final consumption, in accordance with chapter II.

Senator METZENBAUM. We don't have it.

Mr. WENDT. But we are prepared to meet the obligation, Senator. Each country is entitled to have its own measures to meet the demand restraint obligation.

Senator METZENBAUM. The only demand restraint that Mr. Vaughan spoke about was that we would sell more oil from the SPR. What other demand restraint would we have? Other than the market price, which the administration is so proud of?

Mr. WENDT. Well, let me just also cite article 16, Senator——

Senator METZENBAUM. No, let's stay on this.

Mr. WENDT. Well, this is quite relevant.

> When demand restraint is activated in accordance with this chapter, a participating country may substitute for demand restraint measures the use of emergency reserves held in excess of its emergency reserve commitment, as provided in the program.

Senator METZENBAUM. When demand restraint is activated. And demand restraint has not been activated by the IEA. There is no demand restraint on this country. What order are we operating under from the IEA?

Mr. WENDT. We are operating under the obligation that we freely entered into through the international energy program to meet our commitments under the general rubric of demand restraint. That is an obligation that we have accepted.

Senator METZENBAUM. What is that commitment?

Mr. WENDT. The commitment is to exercise the demand restraints.

Senator METZENBAUM. I told you earlier several times that on a voluntary basis the countries have agreed to cut back 5 percent—our country cut back 5 percent, the others didn't; there was no penalties assessed against those companies that didn't, and the point that I am making to you and that you and I seem to be having a lack of communication about is the fact that there was indeed no demand restraint that is imposed by the IEA. But there is, in fact, much demand restraint that has been activated in a number of individual countries, and Mr. Vaughan is going to provide us with that, but I don't think that all of them have even done that.

Mr. WENDT. But, Senator, I do fully understand your point. Let me just say that under the international energy program, there is a formula that requires a certain percentage adjustment in the calculation of the supply which the country is entitled to. So, in order to meet our obligations under the international energy program, we would have to accept that notion of demand restraint.

Senator METZENBAUM. That is only if the program is activated.

Mr. WENDT. That is right.

Senator METZENBAUM. And I am telling you that the program hasn't been activated, and the oil companies are saying that it won't be activated unless there is a fair share plan, and you keep talking in a dreamworld. If it hasn't been activated the other countries do have demand restraints; we do not have demand restraints, and you keep saying something will happen; and what I am saying is this Nation is at peril if there is a closing of the Strait of Hormuz and you have no program.

Mr. **Wendt**. Senator, may I respectfully differ with you on this point. It hasn't been activated now, but certainly the whole program provides for the activation of the system in the event of a serious supply disruption, exceeding 7 percent. We are not in that situation right now, so I am not talking about a dreamworld.

Senator **Metzenbaum**. OK; tell me what happens then. Tell me what happens if there is a supply shortage exceeding 7 percent, what do we have—this gentleman, Mr. Vaughan told me that we would start to sell the SPR oil; Mr. Hodel says we wouldn't.

But be that as it may, that is not a demand restraint; that is a matter of adding additional supplies. We have no program that provides rationing, allocation, anything of the kind. The President vetoed that. Now, what do we have to impose that demand restraint?

Mr. **Wendt**. Mr. Vaughan would like to answer this point, Senator.

Mr. **Vaughan**. Senator, the prime demand restraint of this country is the marketplace. As I indicated earlier, prices will rise; they will dampen demand, and that is what we have said, and that is how we have said we will meet our obligations.

In the event that that is not sufficient, we have the option as every other member of IEA, to supply a greater quantity of oil to the international community. So, that is how this country——

Senator **Metzenbaum**. Wait a minute, wait a minute, wait a minute.

How does supplying a greater quantity of oil to the other nations amount to a demand restraint?

Mr. **Vaughan**. It is written in the agreement that if any country fails to meet the reduction in its consumption—and that is what demand restraint obligation is, a percentage reduction, and if whatever mechanism is used—and by the way, we—every member can use any mechanism it so desires. All it has to be is meet its obligation. This country has chosen in this administration to do that by price. But any country failing to meet its obligation may then make up the difference to oil supply.

Senator **Metzenbaum**. I give up.

Mr. **Vaughan**. That is the section 16 that Mr. Wendt read to you.

Senator **Metzenbaum**. I give up.

I give up as far as the question—but I will oppose the extension of the IEA.

Mr. **Wendt**. Senator, may I just draw your attention to the notion of activation in chapter 4 of the international energy program, article 13. I think it is fairly clear, and it may help us in our discussion of this issue.

It reads:

> Whenever the group—that is the group of IEA countries—sustains or can reasonably be expected to sustain a reduction in the daily rate of its oil supplies, at least equal to 7 percent of the average daily rate of its final consumption during the base

period, each participating country shall implement demand restraint measures sufficient to reduce its final consumption by an amount equal to 7 percent of its final consumption during the base period.

And so on and so forth.

Senator METZENBAUM. I know about that. I read that a long time ago, but that doesn't solve our problem as it cut off today.

Mr. WENDT. I think it——

Senator METZENBAUM. You have got to impose them, but you don't have any mechanism in place to impose them. You have no legislation; you have no program.

Mr. WENDT. Well, Senator, that is a matter of opinion as to whether or not we have the means in place to meet the obligation under the IEA.

Senator METZENBAUM. No, I think it is a matter of fact; and in my opinion, the facts are you have no, no program in effect. This gentleman, when I asked him, said what we would do would be to see how long the Strait of Hormuz are going to be closed; and whether or not we can get them open again.

That is not demand restraint.

I have nothing further.

What are we going to do about reconvening?

The CHAIRMAN. My understanding is that a decision has been made on the Senate floor to have a series of votes starting at 1:45. I think it might be useful for us to break at this point, and return following that, at 2:30.

Mr. VAUGHAN. Senator, are you through with this panel?

The CHAIRMAN. Yes, thank you. Just for the time being.

With that, the meeting will stand in recess from now until 2:30.

[Whereupon, at 1:34 p.m., the hearing was recessed, to be reconvened at 2:30 p.m.]

[Subsequent to the hearing the following questions were submitted to administration witnesses on behalf of minority members. The answers appear in appendix II.]

JAMES A. MC CLURE, IDAHO, CHAIRMAN

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United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, D.C. 20510

October 24, 1983

The Honorable Donald Paul Hodel
Secretary
Department of Energy
1000 Independence Avenue, S.W.
Room 7A257
Washington, D.C. 20585

Dear Mr. Secretary:

In connection with your October 19, 1983 testimony before the Committee on S. 1678 enclosed are additional questions from the minority for the record. Your response by Friday, October 28, 1983, would be appreciated. Your response and any inquiries regarding this request should be directed to the attention of Richard D. Grundy, professional staff member at (224-2564).

Sincerely,

James A. McClure

James A. McClure
Chairman

JAM:nm
Enclosures

QUESTIONS FOR
Mr. Vaughan (DOE)

Group One

1) MR. VAUGHAN, THE U. S. MADE 2 KEY ASSUMPTIONS IN AST-4. FIRST, WE ASSUMED THAT OTHER NATIONS, INCLUDING OUR IEA PARTNERS, FORCE-MAJEURED OUR OWN SPR PROGRAM, THEREBY REDUCING U. S. OIL SUPPLIES AND HENCE REDUCING OUR OBLIGATION TO MAKE VOLUNTARY OFFERS TO SELL OIL TO IEA NATIONS.

SECOND, WE ASSUMED FOR THE FIRST TIME THAT NON-REPORTING COMPANIES WOULD MAKE SIZEABLE VOLUNTARY OFFERS TO SELL OIL TO IEA COUNTRIES.

HAD THOSE TWO KEY ASSUMPTIONS NOT BEEN MADE, WOULD THE U. S. HAVE MET ITS IEA OIL SHARING OBLIGATION?

2) IN AST-4, DIDN'T THE UNITED KINGDOM EXPRESS THEIR SURPRISE TO US THAT OUR GOVERNMENT ASSUMED THAT OIL FROM THE U.K. DESTINED FOR OUR SPR WAS FORCE-MAJEURED? IN FACT, DIDN'T WE ASSUME THAT OIL WAS NOT DELIVERED TO US, WHILE THE U.K. ASSUMED IT WAS DELIVERED THROUGHOUT THE TEST?

3) ON THE SUBJECT OF PREEMPTION, DIDN'T AT LEAST ONE STATE IMPOSE PRICE AND ALLOCATION CONTROLS DURING AST-4?

WHAT WOULD THIS ADMINISTRATION HAVE DONE ABOUT THAT IN A REAL SITUATION?

4) MR. VAUGHAN, IS THIS ADMINISTRATION STILL OPPOSED TO INCLUDING OIL PRICES IN THE NEXT AST-4 TEST? WOULDN'T THE INCLUSION OF OIL PRICES GIVE YOU A BETTER ASSESSMENT OF THE EXTENT WE CAN RELY ON NON-REPORTING COMPANIES TO OFFER TO SHARE OIL IN A REAL CRISIS?

5) IF ONE COMPARES THE SECTION IN S. 1678 ON VOLUNTARY AGREEMENTS AND PLANS OF ACTION VERSUS THE SIMILAR PROVISIONS IN EXISTING LAW (TITLE 50, U.S. CODE, APPENDIX ON WAR AND NATIONAL DEFENSE), ONE FINDS A NUMBER OF SAFEGUARDS NOT CONTAINED IN S. 1678.

FOR EXAMPLE, IN THE CODE TO OBTAIN IMMUNITY FROM THE ANTI-TRUST LAWS REQUIRES A SHOWING OF "GOOD FAITH" AND A SHOWING THAT THE PARTY IN QUESTION ACTUALLY COMPLIED WITH THE VOLUNTARY AGREEMENT. THERE IS AN AUTOMATIC EXPIRATION DATE OF 2 YEARS ON ALL VOLUNTARY AGREEMENTS.

COULD YOU PROVIDE FOR THE RECORD WHICH ADDITIONAL SAFEGUARDS IN EXISTING LAW ON VOLUNTARY AGREEMENTS THAT YOU THINK SHOULD BE INCLUDED IN S. 1678?

GROUP TWO

Question for Assistant Secretary Vaughan (DOE)

From your testimony I take it that the Administration does not endorse S.1678, or at least there are significant revisions that you would want to have incorporated. Is that correct?

GROUP THREE

Questions from Sen. Bradley for DOE

1) Mr. Vaughan, in the AST-4 exercise you sent a message (number 0703) which stated that test participants can assume that appropriate economic response measures would have been implemented during the crisis. You said in message no. 0734, "Clearly, a policy decision of this nature would have been made by the President, with the advice of the Cabinet Council on Energy, the Congress, State officials and others...The economic response issue has been identified, and it should be assumed that the Administration, in consultation with the Congress and State officials, would certainly address this important matter." While the policy decision to implement an economic response could wait until a crisis struck, do you think we can also wait to develop a specific economic response measure? How long do you estimate it would take to fashion such an economic response measure, including legislation? What is your view on the need for such an option? What is DOE doing to develop a specific economic response package?

2) In his testimony on AST-4 before a House subcommittee Ron Winkler, your former deputy, said that he was unable to get interagency cooperation on addressing the formulation of an economic response to the disruption. Please tell us which agencies the DOE contacted on this matter and and how each agency responded. For example we understand that the Treasury department simply balked at believing that the price of oil reached $98 per barrel, that HHS said they were too short on personnel to respond, that the Council on Economic Advisers didn't have time to respond, and that OMB insisted on being only an observer and nothing more. Do you think that our Nation should have an economic response package available for use in an energy disruption? What is the Administration's position on this issue? What do you see as the next step in working on an economic response package? What agency should take the lead on this?

3) Mr. Vaughan, a Memorandum of May 25, 1983, to the Secretary, entitled, "Suspension of New Solicitations for Bids and Purchases of Oil for Filling the Strategic Petroleum Reserve"states in reference to deliveries of oil to the SPR under existing contracts, "We have been advised by the Office of General Counsel that cancellation of suchshipments might require a Presidential drawdown decision, particularly if they are in transit, and if they were loaded FOB origin (meaning the United States took title at the time to loading)." In essence, the memo seems to say that during a disruption the only way to divert shipments of oil away from the SPR and to refineries where the oil can be used is for the President to declare a drawdown of the SPR.Is that correct?

4) Given that the President's declaration of an SPR drawdown is a very significant decision, might not the President be reluctant to declare a drawdown just to achieve a diversion of oil destined for delivery to the SPR? This appeared to be the case in AST-4. Would it be useful for the President to have new, distinct authority in an oil supply emergency to sell and divert shipments of oil destined for the SPR without affecting any SPR oil actually in storage? This would afford the President the opportunity to take limited action to address an oil supply disruption without incurring all the ramifications of an SPR oil drawdown.

GROUP FOUR

QUESTIONS TO STATE DEPARTMENT AND DOE

THREAT OF OIL SUPPLY DISRUPTION

1) THE WASHINGTON POST ~~TODAY~~ Yesterday CARRIED AN ARTICLE ENTITLED "SCHULTZ CRITICIZES IRAN'S THREAT TO CLOSE PERSIAN GULF TO OIL SHIPS".

THE GIST OF THE ARTICLE APPEARS TO BE THAT SECRETARY SCHULTZ DOESN'T WANT IRAN OR ANYONE ELSE USING A THREAT TO CLOSE. THE STRAITS OF HORMUZ AS LEVERAGE TO GAIN CONCESSIONS FROM THEIR OPPONENTS.

IS IRAN CAPABLE OF CLOSING THE STRAITS OF HORMUZ, IF THEY DESIRED? IS THIS AN IDLE THREAT?

2) WOULD IRAN HAVE TO DO MORE THAN SIMPLY USE ENOUGH FORCE TO CONVINCE THE INSURERS (LLOYD'S OF LONDON) OF OIL TANKERS THAT THE STRAITS OF HORMUZ IS A WAR RISK ZONE SO THAT THEY WOULD NOTIFY SHIPPERS THAT THEIR INSURANCE IS VOID IN THAT AREA?

HOW MUCH ACTIVITY WOULD BE NECESSARY TO TEMPORARILY HALT SHIP TRAFFIC THROUGH THE STRAITS?

WHAT OPTIONS WOULD WE HAVE AS A RESPONSE?

COULD WE USE MILITARY ESCORTS AND, IF SO, WHO WOULD INSURE THE TANKERS?

3) How much oil is moving through the Straits of Hormuz? As a percentage of world oil demand? As a percentage of U. S. oil imports?

4) How much of the world's surplus oil production capacity would have to move through the Straits of Hormuz if produced?

5) What do you think would happen to oil prices if Iran halted ship traffic through the Straits of Hormuz?

6) How long do you think this threat will loom over the Straits of Hormuz?

7) Without getting into sensitive matters, are there any other vulnerable points for us besides the Straits of Hormuz, such as Saudi oil installations?

8) THE NEW SECTION 274 OF EPCA, ENTITLED, "VOLUNTARY AGREEMENTS AND PLANS OF ACTION FOR ENERGY EMERGENCIES", EMPLOYS ALMOST VERBATIM THE LANGUAGE WHICH IS IN SEC. 252 OF EPCA REGARDING INTERNATIONAL VOLUNTARY AGREEMENTS.

UNDER THAT SECTION OF EPCA, VOLUNTARY AGREEMENTS AND PLANS OF ACTION MAY BE USED ONLY FOR IMPLEMENTING THE INTERNATIONAL ALLOCATION PROGRAM AND THE IEA INFORMATION PROGRAM.

WHAT DO YOU NEED THIS LANGUAGE FOR IF YOU WANT A FREE MARKET?

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United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, D.C. 20510

October 24, 1983

The Honorable George P. Shultz
Secretary
Department of State
Washington, D.C. 20520

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Sincerely,

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Questions for DOE and State Department
(continued)

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WHAT DO YOU NEED THIS LANGUAGE FOR IF YOU WANT A FREE MARKET?

Questions for the State Department

1) On page 5 of your statement you say that, "The test cannot tell us, for example, whether we should or should not have drawn down the SPR or should have used a system or fair sharing among U.S. companies."

Doesn't the test tell you that if large U.S. oil companies are going to be expected to participate in the voluntary allocation program then either a "fair sharing" program or SPR drawdown will be necessary to induce them to participate.

2) On page 6 of your statement you say that you reaffirmed our commitment to the fulfillment of IEA obligations in a major supply disruption "by reliance on market forces reinforced, if necessary, by supplemental methods such as SPR drawdown." Is this Administration taking a rigid view that under no circumstances would they resort to mandatory measures in order to achieve our IEA obligations or are you including the possibility of mandatory programs under the term "supplemental methods". (Have any of you been told that you will be shot at sunrise if you suggest that this Administration might intervene in the market in order to achieve our IEA obligations?)

JAMES A. MC CLURE, IDAHO, CHAIRMAN
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CHARLES A. TRABANDT, CHIEF COUNSEL
D. MICHAEL HARVEY, CHIEF COUNSEL FOR THE MINORITY

United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, D.C. 20510

November 7, 1983

Honorable William A. Vaughan
Assistant Secretary for Environmental Protection
Safety and Emergency Preparedness
U. S. Department of Energy
1000 Independence Avenue, S.W.
Forrestal Building, Room 4G084
Washington, D. C. 20585

Dear Mr. Vaughan:

I would appreciate it if you would please add these questions to those already submitted from the minority following the hearing on S. 1678, Energy Emergency Preparedness Act Amendments of 1983, which was held on October 19, 1983.

Sincerely yours,

D. Michael Harvey

D. Michael Harvey
Chief Counsel for the Minority

DMH:jbg

Questions from the Minority for William A. Vaughan

Form EP-51

We understand that the API has recommended in a letter of October 27, 1983, to the Energy Information Administration that "EIA eliminate the EP-51 and rely on customs data". Apparently, the API has concluded that the existing customs data from Form 7501 is adequate to satisfy DOE requirements and that EIA should eliminate Form EP-51.

Has API made such a recommendation? What are the differences between the types, quality, and timeliness of information collected under these two forms?

What is the position of the Department with respect to the abolition of form EP-51?

If the form is eliminated what will be the effect on the ability of the Department to meet its EIA information obligations and to monitor international and domestic crude markets and the supply and the price of oil in such markets?

Is the information collected in form EP-51 used by any other agencies? What agencies are involved and for what purposes is this information used in those agencies?

JAMES A. MC CLURE, IDAHO, CHAIRMAN

MARK O. HATFIELD, OREG.
LOWELL P. WEICKER, JR., CONN.
PETE V. DOMENICI, N. MEX.
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CHIC HECHT, NEV.
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D. MICHAEL HARVEY, CHIEF COUNSEL FOR THE MINORITY

United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, D.C. 20510

October 24, 1983

The Honorable William French Smith
Attorney General
Department of Justice
Washington, D.C. 20530

Dear Mr. Attorney General:

In connection with Administration testimony October 19, 1983 before the Committee on S. 1678 enclosed are additional questions from the minority for the record. Your response by Friday, October 28, 1983, would be appreciated. Your response and any inquiries regarding this request should be directed to the attention of Richard D. Grundy, professional staff member at (224-2564).

Sincerely,

James A. McClure

James A. McClure
Chairman

JAM:nm
Enclosures

QUESTION ON S. 1678

FOR JUSTICE DEPARTMENT

1) YOU HAVE EXAMINED S. 1678 CAREFULLY, HAVEN'T YOU, WITH RESPECT TO THE ANTI-TRUST ISSUES IN IT? DID ANYONE IN THE JUSTICE DEPARTMENT PREPARE A MEMORANDUM COMMENTING ON THIS BILL? WAS IT CIRCULATED TO ANY OTHER AGENCY? WHO? DID IT EXPRESS ANY CONCERNS ABOUT THE ANTI-TRUST ASPECTS OF S. 1678, OTHER THAN THE CONCERNS EXPRESSED IN YOUR TESTIMONY CLEARED BY OMB?

   COULD YOU MAKE THAT MEMORANDUM AVAILABLE TO THE COMMITTEE?

QUESTION FOR THE JUSTICE DEPARTMENT

YOU HAVE REVIEWED S. 1678 IN PARTICULAR WITH REGARD TO THE ANTI-TRUST PROVISIONS, HAVE YOU NOT?

ARE YOU COMFORTABLE WITH THE BREADTH OF THE ANTI-TRUST IMMUNITIES IN THIS BILL?

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Questions for Justice Dept.

1) Would you please explain why you did not attend the hearing which you were requested to attend on emergency preparedness on Oct. 19, 1983, before the Senate Committee on Energy and Natural Resources? When did you communicate to the Committee that you would not attend? Who made this communication and how did they make this communication?

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

First, I must apologize for the delay, but, as you probably know, we have had a series of votes on the floor of the Senate that have made it impossible for other members to return. The flurry of activity you have seen up here is to try to determine whether any other members are going to come.

I just talked to Senator Metzenbaum, who has great interest in this subject matter, and he indicated that events have used up the time that he had available and that he is now not able to return.

Under those circumstances, the best thing I can do, with apologies to all of you who have waited patiently and willingly to testify, is to place all of the prepared statements in the record, and to leave the record open for submission of questions in writing, by close of business tomorrow, for responses in writing, if necessary.

And I think that by doing it that way, we accommodate the members of the committee who have expressed an interest, particularly Senator Metzenbaum, and at the same time not unduly long hold you gentlemen and ladies, here.

With that in mind, it is ordered that each of the prepared statements is made a part of the record.

The record will be kept open until the close of business on tomorrow for questions that may be submitted in writing, for responses in writing for the record.

[See appendix I.]

The **Chairman.** I wish to thank every one of the witnesses for their willingness to appear and testify and for the response which has gone in to the prepared statements that are matters for the record. Obviously there is not much point in me sitting here, with you going through those statements, when I have read all the statements anyhow, and I think we can expedite the hearing in this manner.

It is so ordered, and the committee will be adjourned.

[Whereupon, at 2:58 p.m., the hearing was adjourned.]

APPENDIXES

APPENDIX I

Statements of Witnesses Submitted for the Record Along With Answers to Questions for the Record

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

INTERNATIONAL DIVISION

B-203093

The Honorable Howard M. Metzenbaum
United States Senate

Subject: Determination of Oil Price in the International Emergency Sharing System--An Unresolved Issue (GAO/ID-83-15)

Dear Senator Metzenbaum:

In response to your September 30, 1982, request (see app. I), we are reviewing several different aspects of U.S. participation in the International Energy Agency (IEA). This report responds to your specific request for information on U.S. involvement in the fourth test of the IEA Emergency Sharing System scheduled for the spring of 1983 and addresses the major issue of pricing considerations. Although price considerations are generally regarded as an integral part of the allocation system, the United States and other IEA member nations to date have been unable to agree on how pricing considerations could be included in a test. Some countries believe this underscores the difficulties that may occur in the event of an actual emergency.

The United States has taken the position that testing prices in an artificial environment could establish false pricing standards that might compromise the effectiveness of the system for an actual emergency.

Regardless of whether the pricing element is included in the test, underlying differences remain between the United States and other countries on pricing principles to be used in an emergency. These differences should be resolved to minimize the problems that might be encountered if and when the Emergency Sharing System is activated.

BACKGROUND

The process of reallocating oil supplies in an emergency is a complex exercise. [illegible]embers have become increasingly concerned over how to [illegible]e the price of oil that would be shared in an international emergency situation. All tests of the IEA Emergency Sharing System to date have only included volumetric exercises. Factors that determine the price at which oil is traded were not incorporated.

Past tests were designed to develop and upgrade the mechanics of the system; they provided valuable training experience for participants and insights into data requirements, as well as opportunities for assessing the effectiveness of emergency procedures, communications, and national emergency management programs. Each test typically took place over a 4 to 8 week period at IEA headquarters and involved representatives of national governments, oil companies, and the IEA Secretariat. Disruption scenarios were constructed and historical oil company information was used as the basis for operation. Although allocation rights and obligations were assessed, actual diversion of supplies did not take place. In essence, the tests were simulations.

Many observers criticized these tests as being unrealistic on the basis that there was no determination of the price at which oil was to change hands. Our September 8, 1981, report reflects this concern over the failure to include pricing in emergency sharing tests. [1] In addition, the IEA Secretariat and many IEA member governments and oil companies, particularly foreign ones, felt that integrating the transfer price component would enhance the value of the emergency allocation test. Some contended that failure to include price in subsequent tests would cast considerable doubt over the viability of the Emergency Sharing System in an actual emergency.

In the wake of the third test in the fall of 1980, all IEA members agreed to consider the feasibility of integrating price into the 1983 test in order to (1) assess the nature and extent of delays which might be caused in the reallocation process due to pricing negotiations between buyers and sellers, (2) evaluate the extent to which voluntary offers of oil were not made or accepted due to inability to agree on price, and (3) assess the extent to which pricing considerations affected the ability to allocate oil between countries.

FAILURE TO AGREE ON PRICING APPROACH

Disagreement over the feasibility of testing oil pricing has been a major problem in preparing for the 1983 Emergency Sharing

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[1] Unresolved Issues Remain Concerning U.S. Participation in the International Energy Agency (ID-81-38).

System test. Even a proposed compromise by the IEA Secretariat for a limited test has failed to overcome objections by some participating countries and oil companies.

In December 1981, the IEA established a test Design Group composed of several government, oil industry, and IEA Secretariat officials, with the United States as Chairman, to develop procedures for the forthcoming Emergency Sharing System test. The feasibility of testing price has been the dominant concern of the Design Group in its four meetings over the past year. The Design Group commissioned a technical subgroup, also chaired by the United States, to intensively study the pricing issue and to develop an approach acceptable to IEA members for testing price. After considering possible approaches ranging from a totally free market approach to a completely regulated method, the subgroup members agreed to advance a market-oriented proposal with certain limitations.

The Design Group considered the subgroup proposal in a June 1982 meeting. After considerable discussion, Design Group members were unable to reach a consensus. Some members supported the proposed mechanism as a simple and workable approach, while others felt it did not adequately reflect a market approach. Nevertheless, the Design Group advanced the proposal with appropriate qualifying remarks to the IEA's Standing Group on Emergency Questions, which was established by the IEA Governing Board and is responsible for emergency sharing decisions. The Design Group asked for further guidance and urged that the Standing Group promptly address the issue of oil pricing principles for an actual emergency.

The Standing Group on Emergency Questions met in June 1982 and reviewed the Design Group's comments and conclusions on testing price. In that meeting, the majority of IEA governments and oil companies:

--Supported the inclusion of price in the forthcoming test on the grounds that price resolution in an emergency was perhaps the critical problem that must be confronted.

--Indicated that, without some understanding of how oil prices would be determined in a crisis, it would be very difficult if not impossible to allocate oil.

--Contended that participating governments and oil companies could gain considerable useful information on price behavior in an emergency situation as well as experience in negotiating and resolving price differences.

--Believed it would be beneficial to obtain a sense of the impact of including price in the emergency allocation process on the entire IEA emergency system as well as on member countries' domestic emergency systems.

However, due to considerable opposition by the U.S. Government, several U.S. oil companies, and the West German Government, the Standing Group on Emergency Questions was unable to reach a consensus on the mechanism for testing price. Instead, as an interim measure, it approved a Secretariat suggestion to draft a compromise proposal in hopes of obtaining a consensus among member nations.

The Secretariat pricing proposal was completed in July and reviewed by the test Design Group in September 1982. This proposal called for the pricing components to be separated from the overall test, and a special technical expert group to evaluate pricing information that was reported. It excluded any procedures for negotiating prices and resolving price disputes and provided no formula for determining price. The Design Group did not concur in the Secretariat's compromise because:

1. Reported price information would not adequately reflect price behavior in an emergency.

2. Buyer and seller would not negotiate price; but rather price assumptions would have to be used.

3. Results from a test using limited pricing data could be misinterpreted in the development of policy

In rejecting the Secretariat proposal, the Design Group stated that its June 1982 report was still operative and that it was awaiting further guidance from the Standing Group on Emergency Questions.

Because no consensus had been reached, the Standing Group on October 25, 1982, recommended that the upcoming test proceed without the integration of pricing elements. However, as a compromise, an IEA Secretariat proposal was adopted by all IEA members which called for (1) an independent group of experts to follow the test and provide an appraisal of factors that might facilitate the functioning of the Emergency Sharing System, (2) oil company and national representatives to give serious consideration to how to make the system work more effectively, (3) the Design Group to study the usefulness of providing a set of assumed market conditions for the experts as well as company and national representatives, and (4) the development of mechanisms to transmit price data. The Governing Board agreed with the recommendation. It should be noted, however, that pertinent pricing data would not be exchanged or analyzed.

U.S. POSITION

As indicated earlier, the United States as well as West Germany opposed the inclusion of price considerations in the upcoming test on the basis that price behavior in a test would provide no useful information or experience applicable to an actual energy emergency. In fact, the U.S. delegation stated that testing of price in an artificial environment could establish false pricing standards for an actual emergency that might compromise the effectiveness of the Emergency Sharing System. It also contended that technical problems associated with simulating price negotiations would seriously impede successful testing of price. More recently, U.S. Government officials and representatives of several U.S. oil companies have emphasized that unless members of the IEA agree on pricing principles for use in an actual emergency, consideration of price in the next test would not be appropriate or useful.

The U.S. position on testing price appears to have emerged out of meetings of the Interagency Group on International Energy Policy, composed of officials at the assistant secretary level. Representation includes the Department of State, which provides the Group's chairman; the Departments of Energy, Justice, Defense, Commerce, and Treasury; and the Office of Management and Budget. It is our understanding that this Group's decision was made on a consensual basis only after extensive discussions and debate.

In September 1982, the U.S. delegation announced that the U.S. Government opposed any inclusion of pricing in a full test or in the more limited one proposed by the Secretariat in July. The U.S. delegation explained that this position was taken for a variety of reasons, including (1) the conviction that the testing of price would proceed more expeditiously and effectively if uniform pricing principles were more clearly established by IEA member nations, (2) the serious technical problems associated with simulating price negotiations have not been resolved, and (3) considerable doubt exists that company negotiating behavior in a test would be a reliable indicator of behavior in an actual emergency.

The State Department has further explained that in the event of an actual activation of the IEA allocation system, the system managers at IEA headquarters would match oil and receive offers volunteered primarily by oil companies and would inform affected parties of the proposed transactions and leave those parties to negotiate terms, including price, between themselves. The State Department maintains that simulation of this process in a test might prove unrealistic because with no money actually changing hands, it could not be certain that companies' negotiating behavior in the test would accurately mirror their behavior if money were at stake.

U.S. officials have repeatedly expressed concerns about (1) the viability of an Emergency Sharing System test complicated by artificial price scenarios, (2) the usefulness and reliability of conclusions flowing from such a test, and (3) the additional burden that inclusion of price would impose on participating governments and companies and on the IEA Secretariat.

The majority of IEA participating governments and those oil companies that support price testing argue that such a test is no more unrealistic than the testing of other Emergency Sharing System elements which is supported by the U.S. Government as informative and useful in preparation for an actual emergency; i.e., if company behavior might be questionable in resolving pricing matters why would their test behavior in non-pricing matters be any less questionable? In essence, these parties maintain that the test of the Emergency Sharing System is an important contingency planning exercise that is predicated on the belief that all participating parties will attempt to conduct themselves in a responsible manner consistent with their expected behavior in an actual emergency. They also reiterate that if price cannot be incorporated in a test, the difficulty in responding to the pricing issue in a real emergency may well hinder if not cripple the allocation process. Additionally, the IEA Secretariat and most participating oil companies have expressed no major concerns about the burden of testing price.

The primary pricing concern of the United States focuses on what is perceived to be a conflict between the language in the International Energy Program Agreement and in the IEA Emergency Management Manual. According to the Agreement, the objectives of the Program shall include fair treatment for all participating countries and the price of allocated oil shall be based on the price conditions prevailing for comparable commercial transactions. This is generally interpreted to mean that the free market will establish the price of allocated oil. However, the Emergency Management Manual calls for oil to be allocated at term and not spot prices. 1/ This is of concern to many U.S. private oil companies, which believe that in an emergency short-supply situation most oil traded will be at high spot-market prices. These companies believe that the current Emergency Management Manual language unrealistically implies that oil companies might sell oil at prices less than those indicated as comparable commercial transactions under the Agreement.

1/ Spot prices refer to the price of oil not under contract and which can fluctuate on a daily basis; term prices refer to contractual prices that generally remain constant for a longer duration.

U.S. Government officials are concerned that restricting allocated oil prices in an emergency to term prices would be inconsistent with the free market orientation of the Agreement and the thrust of U.S. energy policy. Therefore, since the summer of 1981, the United States has been requesting a full review of this issue within the IEA. The U.S. Government and U.S. private oil companies discussed this issue with the IEA Secretariat and its Standing Group on Emergency Questions, but to date no resolution has been reached.

Many other member governments view the pricing principle issue as being an independent matter. They further explain that the inclusion of price considerations in a test is generally a procedural issue that would provide valuable training and experience regardless of the pricing principle employed. They contend that a meaningful test of price can and should be conducted. Some of these countries also oppose the shift to spot pricing in an actual emergency on the grounds that spot prices would substantially raise their crude oil prices, so they continue to support the use of term prices in an allocation emergency.

In terms of testing price in next year's exercise, the Design Group left the issue open by agreeing to separate the issue of pricing principles in an emergency from the testing of price in the overall emergency system's test. It decided to go forward with efforts to develop a mechanism for testing price without resolving the pricing principles issue. Recently, U.S. Government officials, particularly those at the Department of Energy, attempted to tie the issues together and to make the resolution of pricing principles a prerequisite to testing of price next year. However, critics conversely argue that the testing of price using various assumptions could (1) enhance the participants' understanding of the effects of price on the operations of the emergency allocation system and (2) facilitate a consensus as to pricing principles to be used in an actual emergency.

In June 1982, the Standing Group on Emergency Questions refused to consider the pricing principles issue despite strong urging from the U.S. Government delegation. Instead, its chairman postponed consideration of the issue until December 1982.

AGENCY VIEWS

The State Department informed us that, in its opinion, the IEA emergency oil allocation system can function successfully only if oil traded under the system is priced at market levels. The Department stated that oil company participation in the system is voluntary and that it was unrealistic to expect companies to sell oil at below-market levels. Moreover, it emphasized that no country with an allocation obligation under the system could hope to uphold politically a decision to sell oil in a short-supply situation to another country at a price below that of other oil supplies.

According to the State Department, the IEA system is designed to guarantee member countries access to essential volumes of oil in a crisis, not as a substitute for allocation of oil by the marketplace or as a channel of foreign aid. (See app. II.)

The Department of Energy holds the position that if the IEA relies on market prices in an emergency, companies would be able to recover the marginal costs for oil offered voluntarily. It maintains that if companies perceive that they will not be required to sell oil at less than commercial terms, they may be more willing to participate in the system and thus facilitate its operation. (See app. III.)

SUMMARY

Many IEA member governments and oil companies as well as the IEA Secretariat believe that the determination of price in an emergency using a market-oriented system is preferable. However, there is no agreement as to actual practices to implement this policy. The Emergency Sharing System provides for government intervention and directed allocation of oil supplies in the event voluntary sharing proves unworkable. Thus, a failure to resolve price disputes in an actual emergency could lead to government-directed allocation of oil.

The price of oil in an international emergency is important to the effective distribution of oil supplies among consuming countries. If the 21 IEA member countries that would be called upon to allocate oil in a severe disruption cannot agree on a pricing approach, serious questions could be raised about the viability of the IEA Emergency Sharing System in an actual emergency. The majority of IEA governments and oil companies as well as the IEA Secretariat supported the inclusion of price considerations in the forthcoming test on the basis that price determination and resolution in an emergency is an important issue that member nations must confront. Also, they contend that considerable useful information and experience concerning the behavior of price and necessary government and industry responses could be gained. The U.S. and West German Governments disagree, and without a consensus, pricing considerations will not be included in a test.

Regardless of whether the pricing element is included in the test, underlying differences remain between the United States and other countries on pricing principles to be used in an emergency. These differences should be resolved to minimize the problems that might be encountered if and when the emergency system is activated.

SCOPE AND METHODOLOGY

Our audit work was conducted in accordance with generally accepted government auditing standards. Information in this report was developed through documents from and interviews with U.S. Government and oil company officials, foreign government and oil company officials, and IEA Secretariat officials over the past several months. We also attended meetings of the IEA Industry Advisory Board, AST-4 Design Group, and Standing Group on Emergency Questions. The Departments of State and Energy also provided written comments on specific issues concerning the inclusion of pricing considerations in the upcoming test.

As arranged with your office, no further distribution of this report will be made for 5 days from the date of issue unless you publicly announce its contents earlier.

Sincerely,

Frank C Conahan

Frank C. Conahan
Director

STROM THURMOND, S.C., CHAIRMAN
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QUENTIN CROMMELIN, JR., STAFF DIRECTOR

United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, D.C. 20510

September 30, 1982

Mr. Charles A. Bowsher
Comptroller General of the United States
441 G. Street, N. W.
Washington, D. C. 20548

Dear Mr. Bowsher:

The Senate Committee on Energy and Natural Resources at my request is planning to conduct extensive hearings in the next session of Congress on all issues related to United States participation in the International Energy Agency. In preparation for those hearings, I would like the General Accounting Office to follow up on issues identified as being unresolved in your September, 1981 report on United States participation in the IEA.

I would like GAO to address specifically the following additional issues: (1) U.S. involvement in the IEA's fourth test of its emergency sharing system to be held in the spring of 1983; (2) IEA member country policies and procedures for dealing with pricing of oil in an emergency; (3) the relationship between the IEA emergency sharing system and similar European Economic Community and North Atlantic Treaty Organization petroleum emergency allocation programs; (4) IEA member country policies for and programs to manage and coordinate oil stocks in an emergency; (5) the quality of the IEA Emergency Data System; (6) the responsibility for management of U.S. participation in the IEA; (7) the extent of oil industry involvement in the above activities; and (8) the status of the IEP requirement to conduct a general review of the International Energy Program.

I would like the GAO to monitor as many IEA industry and government meetings as practicable in the coming months in adtion to contacting governmental, industry, and IEA secretariat personnel. The GAO should be prepared to testify at next year's hearings, provide me with a comprehensive follow-up report, and brief my staff on a regular basis.

Once again, I would like to take this opportunity to thank your staff for their continuous high quality assistance on this issue. Their efforts have been extremely helpful in providing the committee and the Congress with independent and objective information and analysis.

Sincerely yours,

Howard Metzenbaum

Howard M. Metzenbaum
United States Senator

HMM/spc

DEPARTMENT OF STATE

Washington, D.C. 20520

Mr. Allan I. Mendelowitz
Associate Director
United States General Accounting Office
Washington, DC 20548

Dear Mr. Mendelowitz:

Thank you for your letter of August 20 to E. Allan Wendt inquiring about consideration of inclusion of oil pricing issues in the fourth test of the International Energy Agency's allocation system (AST-4). Mr. Wendt is out of town, so I shall attempt to respond to your questions.

1. Please describe the methodology developed by the IEA Technical Subgroup to test pricing and the United States' assessment of its strengths and weaknesses.

To date, the AST-4 Design Group has focussed its attention primarily on what guidelines to use for pricing simulated oil transactions under the IEA allocation system during AST-4. Having attended the June meetings of the Design Group and of the Standing Group on Emergency Questions (SEQ), Phillip J. Thomas of your staff has received copies of the relevant working papers and is familiar with the status of deliberations on this subject.

The Design Group has thus far reached no conclusions as to the methodology for including price in AST-4. The Secretariat proposal to be discussed at the September 23-24 Design Group to which you refer on page 2 of your letter contains some discussion of this issue and we are currently studying it.

As you note, the U.S. delegations to the June meetings of the Design Group and SEQ opposed inclusion of price in AST-4. In light of the discussions there, and of the new Secretariat proposal, we are now reviewing this position. We will not be able to comment authoritatively on the merits of the various proposals relating to pricing until this review is complete.

2. What is the explanation for U.S. Government opposition to the testing of price in next year's IEA Emergency Sharing test?

As noted above, the Administration is currently reviewing its position on inclusion of pricing in AST-4 in preparation for the September 23-24 Design Group meeting. We based our opposition to inclusion at the time of the June meetings primarily on concerns about (1) the viability of a test complicated by artificial price scenarios; (2) the usefulness and reliability of conclusions flowing from such a test; (3) the additional burden which inclusion of price would impose on companies, governments, and the IEA Secretariat participating in the test.

3. Why would a test of price be more unrealistic than a test of the other Emergency Sharing System elements which the United States continues to support as informative and useful in preparation for an actual emergency?

In the event of actual activation of the IEA allocation system, the system managers in Paris will match oil supply and receive offers volunteered primarily by oil companies, inform affected parties of the proposed transactions, and leave those parties to negotiate the terms of the transaction, including price, between themselves. Simulation of this process in AST-4 might prove unrealistic only to the extent that, with no money actually changing hands, we could not be certain that companies' negotiating behavior in the test would accurately mirror their behavior if money were at stake.

4. Why did the U.S. Government agree to chair the Technical Subgroup and participate in developing a mechanism for testing price in the forthcoming test if it opposes the testing of price?

The United States did not seek the chairmanship of the Design Group; we were drafted by the other members of the SEQ. IEA members had agreed early in 1981, based upon their experience with AST-3, that we would seriously consider including price in AST-4. This was duly incorporated as one, although by no means the only, objective of the Design Group in the terms of reference established for the Group at its creation last December. Our ability to manage the work of the Design Group in preparing the diverse elements of AST-4 is in no way affected by the U.S. position on the single issue of including price in the test.

5. If there are no pricing tests and it is anticipated that the IEA emergency sharing system in actual operation will rely on a market-oriented pricing policy, what would be the impact on the operation of the Emergency Sharing System and, the distribution of oil supplies?

In our view, the IEA emergency oil allocation system can function successfully only if oil traded under the system is priced at market levels. Oil company participation in the system is voluntary. It is unrealistic to expect companies to volunteer to sell oil at below market levels. Moreover, no country with an allocation obligation under the system could hope to uphold politically a decision to sell oil in short supply to another country at a price below that of other oil supplies. The IEA system is designed to guarantee IEA member countries access to essential volumes of oil in a crisis, not as a substitute for allocation of oil by the marketplace or as a channel for foreign aid.

I hope you find this information helpful.

Sincerely,

John P. Ferriter
Acting Deputy Assistant
Secretary for
International Energy Policy

APPENDIX III

Department of Energy
Washington, D.C. 20585

SEP 13 1982

Mr. Allan I. Mendelowitz
Associate Director
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Mendelowitz:

This letter responds to your request for information regarding the testing of price in the fourth International Energy Agency (IEA) Allocation Systems Test (AST-4).

Our written answers to your questions are enclosed.

Sincerely,

Henry E. Thomas
Assistant Secretary for
International Affairs

Enclosure

Question 1: Please describe the methodology developed by the IEA Technical Subgroup to test pricing and the United States' assessment of its strengths and weaknesses.

Answer 1: The AST-4 Design Group has not developed a methodology to date. The Group has reached no consensus on whether to include price in AST-4 or on what pricing standards or guidelines should be tested.

A special price sub-group of the full Design Group was convened in May to address the pricing standards question. The sub-group concluded that it generally preferred the guidelines proposed by the IEA's Industry Advisory Board (which entail a revision to the existing language of the Emergency Management Manual to make it more consistent with that in the IEP), but also noted certain practical problems associated with their use in AST-4.

The IEA Secretariat has advanced a proposal for a more limited study of price in AST-4, short of a full price test. This proposal is now under review in the Administration.

Question 2: What is the explanation for U.S. Government opposition to the testing of price in next year's IEA Emergency Sharing test?

Answer 2: The U.S. Government is concerned that no clear consensus has emerged within the IEA on pricing standards either for the test or for an actual emergency. At the June meeting of the IEA Standing Group on Emergency Questions, the U.S. agreed to examine the IEA Secretariat's proposal for inclusion of price in AST-4. This proposal, and any others, will be debated at the next Design Group meeting.

Question 3: Why should a test of price be more unrealistic than a test of the other Emergency Sharing System elements which the United States continues to support as informative and useful in preparation for an actual emergency.

Answer 3: The tests of the Emergency Sharing System were designed to fine-tune the mechanics of the System in the event it was ever activated for an oil supply disruption. The process of reallocating oil supplies is a complex exercise. These tests, although paper exercises, provide valuable training experience to participants, both companies and governments, in the mechanics of the sharing process and data requirements.

The IEA system is designed so that, ideally, prices of voluntary offers will be directly negotiated between contracting parties with no interference from the IEA or governments. This negotiating process between parties is particularly difficult to test with any modicum of commercial realism.

Question 4: Why did the U.S. Government agree to chair the Technical Subgroup and participate in developing a mechanism for testing price in the forthcoming test if it opposes the testing of price?

Answer 4: The U.S. Government agreed to chair the Technical subgroup at the request of the Chairman of the Standing Group on Emergency Questions. This position provides us the opportunity to bring our expertise to bear on the pricing issue, focus the discussion on the precise needs of AST-4, and contribute to our overall leadership efforts in the IEA.

Question 5: If there are no pricing tests and it is anticipated that the IEA Emergency Sharing System in actual operation will rely on a market-oriented pricing policy, what would be the impact on the operation of the System and the distribution of oil supplies?

Answer 5: If the IEA relies on market prices, companies would be able to recover the marginal costs for oil offered voluntarily. If companies perceive that implementation of the sharing system will not require them to sell oil at less than commercial terms, they may be more willing to participate in the program. Thus, the impact on the system will be to facilitate its operation.

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-203093

The Honorable Howard M. Metzenbaum
United States Senate

Subject: Assessment of U.S. Participation in the International Energy Agency's Fourth Test of Its Emergency Sharing Allocation System (GAO/NSIAD-84-4)

Dear Senator Metzenbaum:

In response to your September 30, 1982, request we are reviewing several different aspects of U.S. participation in the International Energy Agency (IEA). This report responds to your specific request for an assessment of U.S. participation in the recently completed IEA Emergency Sharing Allocation System Test (AST-4).

AST-4 involved data collection and processing, oil sharing calculations, and oil company and IEA member government cooperation in simulated oil allocations. This test, as with the three previous exercises, assumed political consensus among participating countries, involved no actual redirection of oil, and included no actual implementation of oil demand restraint or other program measures in member countries. The test simulated a major oil disruption over several months of 1981 and involved all 21 IEA member countries. Within the United States, the Departments of Energy (DOE) and State, major oil importing companies, other smaller oil companies, firms in industries holding oil inventories, and representatives from 10 states were among the active participants.

Based on our review, we believe AST-4 provided useful training to government, industry, and IEA Secretariat personnel, many of whom had not participated in the last IEA test. AST-4 also showed that IEA's newly acquired computer system and associated programs can facilitate the processing of oil company voluntary offers in an emergency.

We have identified several concerns regarding U.S. participation in AST-4. It revealed a number of key problems which should be addressed if the IEA Emergency Sharing System is to make a significant contribution to reducing the costs and dislocations of an oil supply interruption. In particular, it focused attention on some of the difficulties the United States might face in relying exclusively on market forces to fulfill U.S. international obligations under the IEA Emergency Sharing System and to cope with the economic impacts of a major oil shortage.

On the operational level, the management of U.S. participation in AST-4 was marked by inadequate preparation and coordination, and inability to resolve disagreements within the executive branch on important test-related issues. In addition, DOE made several assumptions and decisions which may have unduly reduced the U.S. allocation obligation and inclined companies to make much larger voluntary offers for testing purposes than they would in a real emergency situation, raising questions as to how seriously the United States views the sharing system. More specifically, our review showed that:

--There are substantial economic consequences of relying solely on price to restrain demand, and AST-4 participants from the states strongly felt the federal government would have to establish and be ready to implement some revenue recycling measures to address the problem.

--DOE assumed certain behavior for the U.S. oil market that was critical to meeting the U.S. oil sharing responsibility under the test. However, the ability of the market to adjust as quickly and smoothly as DOE assumed does not reflect the realities experienced in prior emergencies.

--Most major U.S. oil companies have said that they would not volunteer oil supplies to the IEA Emergency Sharing System unless a program existed to assure that the burden would be shared equitably with their domestic competitors. Some form of a fair sharing program is probably necessary, although DOE did not use one during the test.

--Other U.S. companies besides the major oil companies that have been working directly with the IEA may be willing to voluntarily share oil with other IEA member nations, but the test did not convincingly demonstrate that these companies can make a significant contribution.

--DOE's decision not to use the Strategic Petroleum Reserve (SPR) and in fact to continue to fill it during a considerable part of the test may reflect the difficulty the U.S. Government might experience in deciding when and how to use the SPR in a real crisis.

--U.S. primary reliance on market forces to cope with the disruption and certain actions taken by the U.S. Government during the test have raised concerns within the IEA and with other IEA countries about the U.S. commitment to the IEA emergency system.

Appendix I provides a more detailed discussion of specific aspects of U.S. participation in AST-4. Appendix II provides additional information on offers made by U.S. firms to meet U.S. allocation obligations during AST-4. Appendix III is a copy of your September 30, 1982, request.

SCOPE AND METHODOLOGY

Information in this report was developed through documents from and interviews with U.S. and foreign government and oil company officials and IEA Secretariat officials over the past several months. We attended meetings of the IEA Industry Advisory Board, AST-4 Design Group, and Standing Group on Emergency Questions. We also monitored U.S. participation during the test on an international and national level and attended post-test assessment meetings.

Our audit work was conducted in accordance with generally accepted government auditing standards. In light of recent hearings on AST-4 held by the Subcommittee on Environment, Energy and Natural Resources, House Committee on Government Operations, at which you, the Departments of State and Energy, and GAO representatives testified, your office requested that we not take the additional time to seek agency comments and we have complied with that request.

As arranged with your office, no further distribution of this report will be made for 5 days from the date of issue unless you publicly announce its contents earlier. At that time we will send copies to the Secretaries of Energy and State, cognizant congressional committees, and other interested parties.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Director

U.S. PARTICIPATION IN AST-4

At the request of Senator Howard M. Metzenbaum, we reviewed U.S. participation in IEA's recent test of its Emergency Sharing Allocation System. We focused our attention on the results of the test for indications of how well prepared the United States would be to meet its emergency oil sharing obligations under the IEA agreement and what potential problems could be anticipated if the IEA Emergency Sharing System were activated in a crisis. We have not evaluated the performance of other member nations.

BACKGROUND

The purpose of the IEA Emergency Sharing System is to facilitate efforts of the 21 member nations[1] to reduce the adverse consequences of a serious oil disruption and to promote balanced sharing of the shortfall among members. Accordingly, the members agree to maintain emergency reserves (equal to 90 days of net oil imports) and to establish measures for reducing oil demand by at least 7 to 10 percent during a serious supply disruption. To balance the sharing of the shortfall, member countries agreed to procedures for determining the impact of the disruption on the supplies of each country and identifying which countries have allocation rights to receive or obligations to provide oil during a disruption.[2]

The Emergency Sharing System consists of three types of allocations, which can be implemented at the same time.

--Type 1 is essentially a continuation of normal commercial transactions by the oil industry, where each company voluntarily rearranges its own individual supply schedule to meet a crisis as it chooses.

--Type 2 is the formal involvement of companies interacting with the IEA, wherein the IEA facilitates reallocation by matching voluntary company offers to receive and provide oil so as to satisfy country allocation rights and obligations.

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[1] Australia, Austria, Belgium, Canada, Denmark, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States, and West Germany.

[2] GAO, Unresolved Issues Remain Concerning U.S. Participation in the International Energy Agency, Sept. 8, 1981 (ID-81-38).

- --Type 3 requires that the IEA Allocation Coordinator notify member governments with allocation obligations (or members with jurisdictions over particular oil companies) that they must order a company or companies to ship oil to countries with allocation rights.

Type 1 and Type 2 allocations, which are essentially voluntary, are expected to take care of the vast majority of reallocation rights and obligations. However, in the event of remaining allocation imbalances, a Type 3 mandatory allocation may occur. Thus, only under Type 3 allocations will member governments require companies to actually reallocate oil. They are involved, however, through their national emergency sharing organizations throughout the allocation process.

To enhance the readiness and efficiency of the Emergency Sharing System, certain operational features of the system have been tested four times. Preparations for the latest test, AST-4, began in December 1981, and continued for 17 months. The test was held in May and June 1983. It involved data collection and processing, oil sharing calculations, and oil company and IEA member government cooperation in simulated oil allocations. The objectives of AST-4 were to:

- --Continue the training of personnel in the oil sharing system in member country governments, oil companies, and the IEA Secretariat.
- --Test modifications made to the system and procedures since the last test (AST-3) held in the fall of 1980.
- --Place special emphasis on involving all elements of member countries' national domestic emergency systems within the overall IEA system.

AST-4, as did previous exercises, assumed political consensus among participating countries, involved no actual redirection of oil, and included no actual implementation of oil demand restraint or other program measures in member countries. The 8-week test, which simulated events over several months of 1981, involved all 21 IEA member countries. Within the United States, the Departments of Energy and State, major oil importing companies, other smaller oil companies, firms in industries holding oil inventories, and representatives from 10 states were among the active participants.

The test was conducted in two parts or "cycles"--the first was a 5-week exercise that involved all parties in simulated oil sharing, while the second was an abridged 3-week exercise that did not include company voluntary offers. In addition, member countries were not expected to test their national emergency procedures through the second cycle, although they could do so.

The disruption scenario for the first part of the test began with historical data for the end of 1980 and hypothesized that a partial blockage occurred in the Straits of Hormuz in the Persian Gulf. Sabotage was also assumed to have resulted in severe damage to Nigerian oil-loading facilities. In addition, the scenario assumed that IEA countries helped to offset the shortfall during the first quarter of 1981 by using 20 percent of their existing oil stocks and that the IEA emergency oil sharing system was activated in mid-February and was operational by March 1. For the March-July period, Persian Gulf supplies were assumed to be reduced by 50 percent and supplies from Nigeria by 75 percent. The net disruption to the IEA members' average monthly oil supplies was 16 percent, about 4.9 million barrels a day (MMB/D), far exceeding the 7-percent minimum trigger level of the IEA Emergency Sharing System. This scenario represents a major international oil supply disruption--much larger than any ever experienced by oil consuming countries.

In response to this simulated crisis, each participating country was to employ its own mechanisms for restraining demand. In a disruption of this magnitude, all IEA member countries initially are expected to use demand restraint measures and to rely on emergency reserves to offset the shortfall. Individual country supply rights and allocation rights and obligations were calculated from past consumption patterns and how the disruption impacted on individual country supplies. Of the 21 members, 12 were expected to supply oil to the other 9. The United States had the largest allocation obligation. Japan, the member most dependent on imported oil, had the largest supply right.

Under the disruption scenario, U.S. oil imports were initially reduced by 1.1 MMB/D and, with its obligation to share oil with other member countries, the United States was required to absorb an additional shortfall of 1.3 MMB/D relative to pre-disruption consumption of about 16 MMB/D. Thus the total U.S. shortfall was 2.4 MMB/D.

PRICES, OIL MARKET BEHAVIOR, AND ECONOMIC CONSEQUENCES

Our analysis indicates that DOE made certain assumptions about the behavior of the U.S. oil market which were central to the ability of the United States to meet its obligations in the test and which had serious economic consequences. DOE assumed that there would be no price controls, no regulations to curb consumption, and no use of other emergency authorities. Necessary reductions in energy use would be effected by an increase in the price of oil. That price was assumed to go to $98 a barrel. At the same time, gross national product (GNP) was simulated to fall, inflation to surge, and unemployment to rise by approximately 2 million.

As part of this approach, DOE initially[3] decided to:

--Avoid any use of allocation or price controls, even on a limited basis.

--Not employ any economic response mechanisms by which the federal government would provide financial assistance to states for such purposes as helping the poor and maintaining essential state and local services.

--Continue filling the SPR with oil previously contracted for rather than divert the oil to the market.

--Not draw down the SPR.

--Not initiate surge production from the Naval Petroleum Reserves.

--Not encourage surge oil production in states having such capacity.

--Not establish state voluntary or mandatory conservation targets.

--Not institute conservation measures at federal facilities.

--Not ease federal regulatory measures to increase electricity from nuclear and coal-fired units.

Immediately following receipt of the IEA disruption scenario, DOE used its Petroleum Allocation Model to determine that the United States would have to reduce its consumption by 2.4 MMB/D to meet its IEA commitments. DOE used its Oil Market Simulation Model to project that oil prices would have to rise to a market-clearing price of $98 a barrel in the United States (average price of crude oil landed in the United States) to achieve that reduction. In making this calculation, DOE made a number of simplifying assumptions.

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[3] With one notable exception, DOE adhered to this approach throughout the test. During the test, it made a major assumption that many oil companies would break existing contracts to provide foreign-produced oil to the SPR. This action, which is discussed later in this report, substantially reduced U.S. oil supplies and in turn the U.S. oil allocation obligation to other IEA countries. In a subsequent simulated policy decision, DOE discontinued solicitations for new SPR contracts effective June 1, which resulted in eliminating virtually all additions to the SPR by July 1.

First, DOE assumed that the $98 a barrel price would be realized within 2 months, from a base price of $38 a barrel. Oil purchasers were assumed to adjust their consumption downward in the aggregate by the exact amount (2.4 MMB/D) required to equal the U.S. supply right within the same 2 month period.

Second, DOE assumed that oil companies, suppliers, and consumers would not engage in substantial stock building--even though the IEA disruption scenario stipulated great uncertainty about future availabilty of oil supplies and oil inventories were assumed to have been heavily reduced by the end of March.

Third, DOE assumed that the $98 price would also clear the world market within the same 2 months. DOE postulated that other IEA countries would offset 1.7 MMB/D of their shortfall by successfully imposing regulatory (i.e., non-market) demand restraint measures and/or by drawing down emergency reserves. This assumption was necessary because DOE's analysis showed that the $98 price was not enough to balance total world supply and demand. However, under the IEA formula, other IEA countries were required to reduce consumption by 2.7 MMB/D. If they accomplished a 2.7 MMB/D reduction by regulatory demand restraint measures and the use of emergency reserves, the world oil price would not have risen to $98 a barrel. In this case, DOE's market approach would not reduce U.S. consumption sufficiently for the United States to meet its IEA commitments.

DOE presented its results to U.S. reporting companies and to all other U.S. AST-4 participants before the companies had to make any decisions about voluntary offers. In presenting its results, DOE did not describe the simplifying assumptions that it had made, with the exception of its assumption that stock building would not occur. In addition, DOE provided the companies with its forecast of prices and consumption through June. The forecast showed price leveling off at $98 a barrel from May through June and consumption falling further in June. DOE told recipients that the information was "guidance" that might be considered an integral part of the disruption scenario.

DOE's assumption that the world, U.S., and other IEA country oil markets would make a rapid and smooth adjustment to a major world oil supply disruption is questionable. For example, the adjustment process evidenced during the 1973-74 Arab oil embargo and the 1978-79 Iranian oil supply interruption was not nearly as quick or smooth, and these disruptions were substantially smaller in size.

We recently reported, based on a GAO model, that oil prices could continue rising during a severe disruption and for several months after it ended.[4] We also found that private oil stock building is a key factor in the upward price spiral accompanying disruptions. However, as noted above, DOE assumed no substantial stock buildup. If stock buildup did occur, it could have equalled or exceeded the 1.3 MMB/D of surplus domestic oil supplies which DOE assumed would quickly result from falling U.S. demand. If this happened, surplus supplies would not be available to help the United States meet its allocation obligation.

A State Department analysis, provided to DOE less than one week before the test began, also differed with DOE's assumptions of a smooth and rapid market adjustment. This analysis concluded there is no apparent reason that the oil market would make an almost instantaneous, smooth adjustment to sizable, sudden shocks. In sum, there could be a significant lag between the advent of a disruption and the full adjustment of world oil trade flows to the price changes, delaying the moment when U.S. oil production and consumption would respond fully to the consequences of a shortfall. Several officials of major U.S. oil companies have expressed a similar view.

By relying solely on oil price increases to meet IEA demand restraint goals and emergency reserve drawdown obligations, DOE estimated that the price of gasoline would rise to $2.83 a gallon and the price of residual fuel would more than double within the first 2 months after the IEA Emergency Sharing System was activated. DOE also projected that at $98 a barrel, the demand for oil in the second half of the year would drop by 22 percent.

The economic consequences of using a strict market-oriented approach which minimized government involvement would be severe. DOE forecasted substantial reductions in U.S. manufacturing activity and the GNP and significant increases in unemployment and consumer prices. For example, DOE estimated that GNP would be 5 to 6 percent lower for the balance of 1981 compared with the undisrupted performance of the economy, the unemployment rate would be 2 percentage points higher by the third quarter, and the inflation rate would be higher than the pre-disruption case by 9.5, 8.1, and 3.6 percent for the second, third, and fourth quarters, respectively.

Although no projections were made by the U.S. Government concerning the international consequences of such a major increase in crude oil prices, less severe disruptions during the past decade clearly reflect that such rapidly rising crude oil prices would have serious destabilizing effects on the world economy.

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[4] GAO, Oil Supply Disruptions: Their Price and Economic Effects, May 20, 1983 (GAO/RCED-83-135, pp. 16 and 19).

EXCLUSION OF PRICE FROM AST-4

Although price was used domestically by the United States, price was not included in the simulated international allocation of oil under the IEA sharing system. Member country governments and participating oil companies failed to reach agreement on a method for determining the price at which oil would be exchanged in AST-4. After AST-3, all IEA members agreed to consider the feasibility of integrating price into AST-4 to (1) assess the nature and extent of any delays in the reallocation process due to pricing negotiations between buyers and sellers, (2) ascertain the extent to which voluntary offers of oil were not made or accepted because of price disagreements, and (3) assess the extent to which pricing considerations hindered oil allocations between countries.

During the 17 months of preparations that preceded the test, discussion among governments and companies on how to include price in the test was the dominant issue, but agreement on an acceptable approach was never reached.[5] The United States, West Germany and several major U.S. and foreign oil companies eventually opposed including price in AST-4. They indicated that price behavior in a test would provide no useful information or experience applicable to an actual energy emergency. The U.S. delegation stated that testing of price in an artificial environment could establish false pricing standards that might compromise the effectiveness of the Emergency Sharing System in an actual energy emergency. It also contended that technical problems in simulating price negotiations would seriously impede the test. More recently, U.S. Government officials and representatives of several U.S. oil companies have emphasized that unless IEA members agreed on pricing principles for use in an actual emergency, consideration of price in a test would not be appropriate or useful.

Other IEA participating governments and those oil companies that supported inclusion of pricing in the IEA test argued that integrating price into the exercise was as realistic as the testing of other Emergency Sharing System elements. They asked why company behavior would be more questionable in resolving pricing matters than in other aspects of the test.

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[5] GAO, Determination of Oil Price in the International Emergency Sharing System--An Unresolved Issue, Nov. 12, 1982 (GAO/ID-83-15).

ALLOCATION OBLIGATIONS, FAIR SHARING, AND VOLUNTARY OFFERS

Under the IEA Emergency Oil Sharing System, the majority of international oil allocations are expected to be achieved through a continuation of normal commercial transactions by the oil industry and voluntary offers by oil companies to share oil through the IEA process. That is, member governments would not generally mandate redirection of oil to meet IEA obligations. If allocation imbalances remain, the IEA can notify member governments with unfulfilled obligations that they must order a company or companies in their country to ship oil to countries with allocation rights. To increase the likelihood that member countries can satisfy allocation obligations without government intervention, the IEA has long held that member countries should establish a fair sharing program to ensure that the burden of sharing is borne proportionately by all oil companies. When IEA was created, the international oil companies indicated that they would not volunteer oil supplies to the IEA system unless they were assured that the burden would be shared with their domestic competitors in a fair manner. When the United States joined the IEA, fair sharing was to be carried out under the broader domestic crude oil allocation system then in place.

In early 1981 the United States abolished oil allocation and price controls. While this action was generally well received by the oil industry, the industry said that a limited standby program for emergency oil distribution should be available for use in severe emergencies. The industry said this was necessary if international companies are to be encouraged to make voluntary international reallocations.

In July 1981 DOE informed the Congress that it planned to develop a contingency plan for a limited crude oil fair-sharing system to backstop voluntary offers, for activation should the President deem it necessary to meet U.S. IEA obligations. DOE subsequently planned to examine options for a fair-sharing program, prepare interim action plans, and complete final action plans by September 1982. These plans were also to be available for use in AST-4. However, when AST-4 got underway in May 1983, DOE still had not established a fair sharing program. Moreover, during the test DOE decided against using any fair-sharing program unless it became absolutely necessary. DOE assumed that its market-based approach for coping with emergencies might preclude any need to employ a fair-sharing program or that other options, (that is, drawdown of the SPR and a system of direct supply orders to various companies) might be relied on should that assumption prove false.

During AST-4, U.S. companies offered to share far more oil than the amount required by the test. For the first part of the test the United States had an allocation obligation of 3.1 million metric tons (MMT) and net voluntary offers received for that period totaled 8.1 MMT, or more than double the U.S. obligation. A company makes a net voluntary offer when the oil it is willing to share exceeds any oil it receives under the IEA sharing system. Nearly two-thirds of the offers were made by non-reporting companies,[6] including industrial energy consumers. (See app. II for the specific numbers.)

A matched offer occurs when a company's offer to give a particular kind and amount of oil is matched by the IEA with another company's request for oil. Net voluntary offers from U.S. companies totaling 3.9 MMT were matched with other IEA countries' requests for oil. This amount was well above the U.S. allocation obligation of 3.1 MMT.

Based on these results, DOE concluded that the test demonstrated that government and private industry can respond quickly and effectively to oil supply interruptions through voluntary, market-based programs and that a fair sharing program was not needed during the test. DOE also said that it did not encounter any significant problems in seeking voluntary offers.

However, we found problems with company voluntary offers. More specifically, the test indicated that a fair sharing system would probably be required to secure substantial voluntary offers from reporting companies. Concerning the non-reporting companies, we found that DOE did not correctly follow the IEA's long-established and well-documented procedures for securing voluntary company offers. Some of the non-reporting companies' offers appear to be unrealistic. Guidance which these companies received from DOE may have influenced them to make offers that would not be made in a real disruption. Consequently, we believe that limited conclusions can be drawn about the future role of non-reporting companies.

Reporting company offers

Of 19 U.S. reporting companies,[7] 14 made voluntary offers and 10 of those made net voluntary offers. Reporting company net voluntary offers totalled 2.9 MMT,[8] or an amount slightly less than the U.S. allocation obligation. Their net matched voluntary offers equalled 1.8 MMT, or less than two-thirds of the allocation obligation.

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[6] "Non-reporting companies" refers to companies operating in IEA countries which are engaged in producing, importing, or exporting oil or holding certain kinds of oil inventories but which do not regularly participate in IEA activities nor report directly to the IEA during an emergency.

[7] Reporting companies are major oil companies invited by the IEA and approved by their respective governments to actively participate in IEA activities. They agree to report to the IEA directly about their volume and flow of oil in an emergency.

Of the 14 reporting companies that made voluntary offers, 10 either told DOE well before the test that fair sharing would be necessary to induce them to make voluntary offers through the IEA system and/or specifically assumed during the test that a fair sharing system was in place. The combined offers of these companies accounted for 88 percent of net reporting company voluntary offers and 95 percent of their net matched voluntary offers.

The other 4 reporting companies have said that a fair-sharing system is not needed for them to make voluntary offers within the IEA system. Together, these companies accounted for only 12 percent of reporting company net voluntary offers and only 5 percent of reporting company net matched offers.

Non-reporting company offers

AST-4 was the first IEA test to involve U.S. non-reporting companies. Shortly before the test, DOE identified about 30 of the largest oil importing companies that were not reporting companies and about 40 industrial companies that use large amounts of oil, including firms in motor vehicle production, metal refining, and pulp and paper production, and invited them to participate in the test exercise.

Total net voluntary offers made by these non-reporting companies during the test were 5.1 MMT, or about 1.7 times greater than the cumulative U.S. allocation obligation of 3.1 MMT. The offers of the non-reporting companies were also substantially greater than the reporting companies' total net offers of 2.9 MMT. This response was surprising, since non-reporting companies accounted for less than one-third of U.S. oil imports and less than two-fifths of total U.S. oil supplies. The amount of non-reporting company offers that was successfully matched with foreign requests was about 2.1 MMT, which seemed to indicate that non-reporting companies could make an important contribution to the IEA Emergency Oil Sharing System. However, our examination of these voluntary offers and how they were made raises a number of questions about their credibility.

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[8] During AST-4, reporting companies offered an additional 1.9 MMT of oil that was contingent upon receiving a comparable amount of oil from U.S. non-reporting companies. These swaps were arranged at the initiative of the IEA and do not represent net voluntary offers for the reporting companies.

In soliciting offers from non-reporting companies, DOE did not request certain important information needed to determine whether companies could realistically make offers within the prescribed time period and whether specific offers could be successfully matched with companies in other countries in need of oil. More importantly, DOE did not instruct the non-reporting companies that before deciding whether and how much they could offer, they should first reduce their stock levels by the assumed inventory drawdown of 22 percent and calculate whether and how their supply positions had been reduced by the simulated disruption of oil in specific producing countries. Such adjustments could have critically affected a company's willingness and ability to make voluntary offers and the size of its offers.

According to various DOE records, 26 or 27 non-reporting companies made 52 voluntary offers which were then submitted by DOE to the IEA (9 companies made multiple offers). However, in terms of the total volume of oil offered, a handful of companies accounted for the large majority of the oil.

Our analysis showed that:

--Significant information was missing for three-quarters of the 52 offers made by non-reporting companies. Before forwarding the offers to the IEA, DOE made estimates, based upon DOE staff expertise, of what might be realistic information for the missing data.

--Some of the non-reporting companies' offers submitted to the IEA, with data added by DOE, were quickly recognized as improbable or erroneous by IEA industry experts who were checking the offers.

--One non-reporting company accounted for more than two-thirds of all non-reporting company net offers. The company provided DOE with minimal information on its offers. When the IEA raised questions, DOE sought to secure additional information from the company, but an official of the company indicated that it did not have sufficient time to examine its historical records. To deal with this problem, the original offers were rejected and the IEA and its Industry Supply Advisory Group simulated new offers by making their own best estimates about the missing data.

--Doubts remain about the realism of the offers made by the company discussed above. For example, the company offered more oil than the entire U.S. allocation obligation for the test period and more oil than the combined net voluntary offers of all reporting companies. Moreover, the total oil it offered was greater than all the oil it imported into the United States during 1981. According to an official of the company, it did not adjust its stocks downward by 22 percent, as required by the IEA disruption scenario procedures, before deciding what offers to make nor reduce its supplies to account for oil lost from countries whose oil production had been disrupted. Finally, an official of the company told us that its offers were predicated solely on the assumption that it could get a better price through the voluntary offers. If it could have got a better price in the United States, it would have done so.

--In at least 7 cases, DOE combined offers by two or more companies and/or offers of products in a variety of locations (frequently widely separated) and represented the result as a single offer available at a particular port.

SPR NOT USED IN TEST OF MAJOR DISRUPTION

During the period for which a U.S. response was simulated, the SPR contained approximately 135 million barrels of crude oil with a maximum drawdown capability of 1.6 MMB/D for 45 days followed by 1 MMB/D for 20 days.

The experience of the United States in deciding whether, how, and when to use the SPR in AST-4 may reflect the difficulties that would be encountered in a real emergency. DOE's initial decision during the test was to continue to fill the SPR at levels of about 155,000 barrels a day for March 1981, 445,000 barrels a day for April, and 510,000 barrels a day for May 1981. This decision was made on the basis that:

--the unknown duration of the disruption and the possibility it might worsen made it prudent to be cautious in initiating any action to draw down or stop filling the SPR;

--any decision to stop filling the SPR would not be immediately effective and would take considerable time to have an impact on the U.S. market;

--the SPR was not large enough to use at an early stage of the disruption;

--market forces alone were assumed to be adequate to reduce U.S. demand to the level required for the United States to meet its international commitments;

--AST-4 was primarily an international allocation test and not a test of the SPR and, therefore, reliance on the SPR would reduce benefits of testing the international system; and

--a separate test of SPR drawdown procedures was scheduled to get underway shortly after the conclusion of AST-4.

Following the U.S. announcement that the SPR would continue to be filled, criticism was directed at the U.S. Government for not using the SPR. Several state government and congressional participants were particularly critical of the U.S. failure to act. They contended that, despite arguments put forth by the administration, DOE should have taken one or more of the following actions: stop filling the SPR, cut the rate at which the SPR was being filled, or use oil from the SPR. Although critics acknowledged that these actions might have only a minimal impact on the disruption, they hoped that SPR use would at least moderate the severe oil price increases and associated economic effects. They noted that while AST-4 was a test of the international allocations system, it was also a test of national emergency response systems.

Two weeks into the test, DOE took a major action by assuming that most oil imported into the United States under contract for the SPR was cut off as a result of suppliers invoking force majeure.[9] Under this assumption, the involved companies (all non-reporting companies) maintained that the petroleum supply interruption was an event beyond their control and they were unable to fulfill their contracts. In announcing the action, DOE said that the decision was based upon actual experience during the 1979 Iranian oil supply interruptions and that the purpose of the action was to simulate the real world.

According to DOE's Deputy Assistant Secretary for Energy Emergencies, a principal reason for making the force majeure assumption was that it provided a quick means, for test purposes, to stop filling the SPR. DOE's Office of General Counsel had advised that cancellation of deliveries to the SPR for which contracts had already been completed might require a Presidential SPR draw down decision, particularly if they were in transit and if they were loaded f.o.b., meaning the United States took title at the time of the loading. Deliveries possibly could have been rescheduled, but that also would involve difficulties.

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[9] A term of law referring to an irresistible force or an act of God that may justify the discharge or non-performance of a party's contract obligations.

While it is possible that some companies selling foreign oil to the United States might have cause to invoke force majeure, the assumption that this would happen to most of the oil being imported for the historical period defined by the test was questionable. The large majority of oil affected by the force majeure assumption was coming from countries whose oil production was not disrupted. Over two-thirds of the oil originated in the United Kingdom, a major U.S. ally and IEA member country.

The force majeure decision created problems in the test. It disrupted allocation rights and obligations. The decision implied that the British Government might cut off or sanction a cut-off of supplies in an international energy crisis. The decision was not coordinated with the United Kingdom and the British Government refused to accept the U.S. assumption and thus would not modify its oil data submitted to the IEA to show a commensurate decrease in its exports to the United States.

Some IEA officials and test observers perceived the U.S. decision as designed to further reduce the U.S. allocation obligation rather than being responsive to calls to use the SPR. A major effect of the assumption was to reduce U.S. oil imports by 3.7 MMT for the simulated May-July period, reducing the U.S. allocation obligation by 54 percent. Without the force majeure assumption, the obligation would have been 6.8 MMT. Although total U.S. net company voluntary offers of 8.1 MMT were greater, given the problems previously discussed, there is a real question whether the IEA could have made sufficient additional matches to meet the higher obligation.

In a simulated announcement on June 1, the Secretary of Energy announced the suspension of new purchases of oil for filling the SPR. That decision eliminated most SPR fill as of July 1 and made available to the market an additional 88,000 barrels of oil per day. The Secretary of Energy took the action in part as an effort to reduce the upward pressure on world oil prices and to make more oil available on the market. However, in taking this action, the Secretary said the SPR itself would not be drawn down, stating that market forces and stopping the SPR fill were adequate responses to the situation.

The decision to cease new solicitations for the SPR had little effect during the first part of the test.

VIEWS OF THE STATES

DOE asked 10 states to participate actively in the simulation exercise. These were California, Florida, Kansas, Maine, Mississippi, New York, Texas, Vermont, Wisconsin, and Wyoming. It also secured the involvement of the National Governors' Association (NGA), which would play an important role during a real disruption in articulating state interests for the Congress and the executive branch. The comments of the states highlighted an important problem not considered in the test, but likely to arise in a real crisis.

Several states indicated their willingness to give the administration's free market approach an opportunity to work--provided that certain measures were taken to reduce or mitigate the effects of the disruption. However, the majority of states disputed DOE's assumption that the free market would work quickly and smoothly. For example, California, New York, and Maine simulated product imbalances in their respective states or regions. Several states supported enactment of standby price and allocation controls, and several critized DOE for not providing them with adequate information to evaluate their petroleum supply situations.

The states concluded that the federal government was best situated to deal with the economic consequences associated with the free market approach, i.e, unemployment, declining state revenues, and the social costs of high energy prices, since federal revenues from the crude oil windfall profits tax would increase significantly due to higher oil prices. They indicated their desire to work with the administration in developing and supporting an initiative in this area. However, according to DOE officials, the agency was not responsive because (1) the administration was working on a legislatively mandated analysis of the impact on the domestic economy of reliance on market allocation and pricing during any substantial reduction in the amount of petroleum products available to the United States and (2) high-level economic policymakers in the administration, but outside DOE, were unable to participate actively in the test. However, it should be pointed out that by November 1982, 5 months before the AST-4 simulation began, DOE had completed operations manuals for the use of two alternative economic response measures--block grants to states and temporary tax reductions.

The states were virtually unanimous that a federal economic response package was necessary. Working along with the NGA, they simulated congressional passage of a bill to provide financial assistance to the states. As the test drew to a close, the bill was sent to the President.

MANAGEMENT PROBLEMS

Normally, management of U.S. participation in the IEA is shared between the Departments of State and Energy, with the Interagency Group on International Energy Policy reviewing significant IEA matters and making policy recommendations. For the purposes of AST-4, the Department of State, with assistance from DOE's Office of International Affairs, had the primary role for international involvement, while DOE's Office of Energy Emergencies was principally charged with domestic test management responsibilities.

Although the United States committed a large number of people to the test (for example, over 80 persons from DOE were involved part- or full-time during the test) and began preparations 17 months in advance, it was not ready for the test in a number of areas. DOE decided to integrate the non-reporting companies into the test at the last moment. DOE sent letters to non-reporting companies soliciting their participation less than 2 weeks before the test began and then, during the test, obtained insufficient information from these companies on their voluntary offers to the IEA. Given the absence of past involvement of non-reporting companies in such tests, DOE should have developed procedures for managing their participation much earlier. Not doing so resulted in distorted non-reporting company voluntary offers, which created problems in the test.

Another example of shortcomings in the U.S. preparation was the fact that a comprehensive management manual delineating organizational responsibilities and procedures for carrying out U.S. emergency management responsibilities in an IEA test or in an actual crisis was never finalized. Only draft manuals with incomplete information were produced, and a final National Emergency Sharing Organization (NESO) Management manual is still unavailable.

Furthermore, DOE's Office of Energy Emergencies was not adequately familiar with IEA test procedures. The Deputy Assistant Secretary for Energy Emergencies, the day-to-day operational head of the U.S. NESO, has acknowledged that he had not read the test guide until after the test began. He said that his staff was generally not well acquainted with the details of the IEA system and therefore had difficulties in complying with specifics of the system, particularly as it related to processing of non-reporting company voluntary offers. However, several members of his staff did participate extensively in preparing the IEA's AST-4 test guide.

During and after the test, DOE's Office of Energy Emergencies was criticized by DOE's Office of International Affairs and the State Department for inadequately understanding the IEA test guide procedures on reporting energy information, making voluntary offers, and conforming to test assumptions and conditions.

From the onset of test preparations, disagreements surfaced between DOE's Office of Energy Emergencies and Office of International Affairs and the State Department's International Energy Policy Group. Part of these differences emerged because

--responsibility for U.S. domestic and international involvement in AST-4 was divided between agencies and sub-agencies and there was inadequate communication and coordination among them and

--interpretations differed concerning the nature of the U.S. commitment under the International Energy Program (the international agreement under which the IEA was established), and the different ways the commitment can be met were not resolved in a higher level interagency forum.

Decisions during the test on the issues of fair sharing, demand restraint, and use of the SPR were made without adequate coordination. In each of these cases, DOE's Office of Energy Emergencies had ample advance opportunity to seek a government-wide consensus on a series of acceptable options before the test, but chose not to do so.

Despite these obvious disagreements on key assumptions and decisions, the established interagency process was not used to resolve them. These disagreements helped foster the impression among other IEA members, the Secretariat, and participating oil companies of a confused and somewhat contradictory U.S. approach to AST-4.

OTHER ASSESSMENTS OF AST-4

Following the AST-4 test, major IEA participants including the Secretariat, a Government/Industry Test Design Group, the IEA Standing Group on Emergency Questions (composed of senior representatives of participating country governments), oil companies, and an independent group of oil market experts, completed individual assessments of the test. Overall, these groups concluded that the test had been a useful training exercise, but they raised several concerns about the viability of the system in a real crisis.

Many of these concerns were tied to U.S. participation in the test. Areas of principal concern cited included the lack of pricing in the voluntary offer process, the impact of the United States relying exclusively on oil price increases to achieve demand restraint objectives, the absence of a U.S. fair-sharing program, and the problems with the U.S. non-reporting company offers.

The international assessments indicated a need for participating countries to have appropriate demand restraint and fair-sharing programs in place if the IEA voluntary offer system is to work effectively in a real emergency. These assessments focused attention on the importance of compatible national emergency systems to the successful operation of the entire IEA Emergency Sharing System. Several groups concluded that reliance on unrestrained price escalation would not be in keeping with each nation's commitment to the IEA. They indicated that a U.S. approach that relies on price increases as its principal, if not exclusive, response to a major oil supply disruption presents serious problems for the IEA sharing system.

The above concerns about U.S. participation in AST-4, in addition to being raised in a multilateral context, were also expressed by delegates of IEA member governments and the IEA Sécretariat on a bilateral basis with representatives of the U.S. Government in Washington and abroad.

In the final analysis, the major contribution of a test such as AST-4 is to identify shortcomings that may cause problems in a real emergency. To the extent that evaluations of AST-4 identify problem areas and prompt corrective action, the test will have served a useful purpose.

To this end, the United States agreed at a recent meeting of the IEA to participate in the IEA review of selected national government emergency response mechanisms. The U.S. Government agreed to be one of the first countries to be reviewed.

COMPANY OFFERS TO MEET U.S. ALLOCATION OBLIGATION DURING AST-4 TEST

	Net voluntary offers[a]	Net offers matched by IEA
	(thousand metric tons)	
Reporting companies	2,951[b]	1,821[b]
Non-reporting companies	5,166	2,091
Total	8,117	3,912

[a] A company has net voluntary offers when the total oil it gives exceeds the oil, if any, it receives through the IEA Emergency Sharing System. During AST-4, reporting companies offered an additional amount of 1.9 MMT of oil that was contingent upon receiving a comparable amount of oil from U.S. non-reporting companies. These swaps were arranged at the initiative of the IEA and based upon voluntary offers by non-reporting companies.

[b] As discussed in the text, most of these offers were made by companies which either told DOE before the test that fair sharing would be necessary to induce them to make voluntary offers through the IEA system or specifically assumed a fair-sharing system was in place when they made their offers.

Source: Based on DOE statistics, which have not been fully reconciled with IEA statistics.

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United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, D.C. 20510

September 30, 1982

Mr. Charles A. Bowsher
Comptroller General of the United States
441 G. Street, N. W.
Washington, D. C. 20548

Dear Mr. Bowsher:

The Senate Committee on Energy and Natural Resources at my request is planning to conduct extensive hearings in the next session of Congress on all issues related to United States participation in the International Energy Agency. In preparation for those hearings, I would like the General Accounting Office to follow up on issues identified as being unresolved in your September, 1981 report on United States participation in the IEA.

I would like GAO to address specifically the following additional issues: (1) U.S. involvement in the IEA's fourth test of its emergency sharing system to be held in the spring of 1983; (2) IEA member country policies and procedures for dealing with pricing of oil in an emergency; (3) the relationship between the IEA emergency sharing system and similar European Economic Community and North Atlantic Treaty Organization petroleum emergency allocation programs; (4) IEA member country policies for and programs to manage and coordinate oil stocks in an emergency; (5) the quality of the IEA Emergency Data System; (6) the responsibility for management of U.S. participation in the IEA; (7) the extent of oil industry involvement in the above activities; and (8) the status of the IEP requirement to conduct a general review of the International Energy Program.

I would like the GAO to monitor as many IEA industry and government meetings as practicable in the coming months in addition to contacting governmental, industry, and IEA secretariat personnel. The GAO should be prepared to testify at next year's hearings, provide me with a comprehensive follow-up report, and brief my staff on a regular basis.

Once again, I would like to take this opportunity to thank your staff for their continuous high quality assistance on this issue. Their efforts have been extremely helpful in providing the committee and the Congress with independent and objective information and analysis.

Sincerely yours,

Howard M. Metzenbaum

Howard M. Metzenbaum
United States Senator

HMM/spc

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

January 3, 1983

B-210236

The Honorable James A. McClure
Chairman, Committee on Energy and
Natural Resources
United States Senate

The Honorable John Warner
Chairman, Subcommittee on Energy
and Mineral Resources
Committee on Energy and Natural
Resources
United States Senate

The Honorable Henry M. Jackson
United States Senate

The Honorable Bill Bradley
United States Senate

Subject: Analyses of the Strategic Petroleum Reserve Drawdown Plan and the Strategic Petroleum Reserve Drawdown and Distribution Report (GAO/RCED-83-85)

In your August 11, 1982, letter you requested that we monitor and analyze documents to be prepared by the administration under the Energy Emergency Preparedness Act of 1982 (EEPA). 1/ Specifically, you requested that we report, within 30 days, on two documents regarding drawdown of the Strategic Petroleum Reserve (SPR) that were submitted to the Congress on December 1, 1982: (1) the Strategic Petroleum Reserve Drawdown Plan (pursuant to section 4(c)) and (2) the Strategic Petroleum Reserve Drawdown and Distribution Report (pursuant to section 6(b)).

The Strategic Petroleum Reserve Drawdown Plan (referred to below as "the SPR Plan") replaces an earlier plan that had been in effect since 1979. The Plan is required to set forth the method of drawdown and distribution of the SPR, under the Energy Policy and Conservation Act of 1975 (EPCA).

1/Pursuant to this request, we have already issued one report, "Status of the Administration's Implementation of the Energy Emergency Preparedness Act of 1982," GAO/RCED-83-33, October 8, 1982. That report discussed whether the statutory requirements and deadlines would be met, and reviewed the extent of interagency coordination in developing and approving the reports required by the statute.

(001715)

The Strategic Petroleum Reserve Drawdown and Distribution Report (referred to below as "the SPR Report") was required by EEPA to contain (1) a description of the "foreseeable situations," which could necessitate distributions from the SPR and (2) descriptions of alternative strategies of distribution (with the theory and justification for each), which could be used to respond to each of these situations. The "foreseeable situations," according to EEPA, include selective and general embargoes, sabotage, war, act of God, or accident.

An important difference between the SPR Plan and the SPR Report is that the Plan is binding on the administration; the administration is required under EPCA, section 161(b), to abide by the terms of the Plan during any future SPR drawdown. No such requirement commits future administration drawdown decisions to conform to the SPR Report.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to examine how well the two reports complied with the requirements of EEPA. We reviewed the House and Senate Committee Reports, Conference Reports, and hearings to better clarify what the Congress intended to be included in the documents. We also relied on GAO's extensive past and ongoing work on the SPR and energy emergency planning issues as part of our own determination of what constitutes adequate SPR drawdown and distribution planning.

We obtained additional information for this assessment from interviews with, and materials supplied by, officials in DOE's Office of Energy Emergencies and Strategic Petroleum Reserve Office. Additional interviews were conducted with DOE contractors working on this subject and with other experts in energy emergency planning. We also interviewed experts from the National War College to gain further insights into the military contingency planning process, and how this process could relate to contingency planning for SPR use.

DOE's Assistant Secretary for Environmental Protection, Safety, and Emergency Preparedness and his staff cooperated fully and provided us with information needed for this report. Our audit work was conducted in accordance with generally accepted government auditing standards.

THE SPR PLAN AND REPORT GIVE LITTLE SPECIFIC INFORMATION ON HOW THE SPR COULD BE USED IN AN OIL SUPPLY DISRUPTION

Neither the SPR Plan nor the SPR Report provide much specific information about the conditions in which SPR oil could be used in an emergency, including the amount, rate, and timing of its use.

In the case of the SPR Plan, the administration explicitly opposed providing specific details on SPR drawdown because it could constrain the President's flexibility in dealing with an emergency. DOE's Assistant Secretary for Environmental Protection, Safety, and Emergency Preparedness, while testifying last May against EEPA's requirement to update the SPR Plan, 1/ stated that "rigid plans for drawdown and distribution make little sense and, if developed and made public, could impair the effective use of the SPR."

The Plan does contain several key provisions about SPR drawdown and distribution (notably a provision for a 10-percent "set-aside" of SPR oil and a rejection of an automatic "trigger" for SPR drawdown), which we discuss in the enclosure. However, many important details are not discussed, particularly about the circumstances that would lead to an SPR drawdown. Emphasizing the high degree of uncertainty involved, the Plan states that "drawdown decisions must be based on estimates of how long the interruption may last, the likelihood of subsequent interruptions, and whether there will be opportunities to refill the SPR between interruptions."

The Plan also contains several SPR use objectives and some "policy considerations pertaining to SPR use." However, these objectives and policy considerations are merely stated; there is no clear connection between them and decisions on when and how to use the SPR.

The lack of detail in the SPR Plan would not be as much of a problem had more information been contained in the SPR Report. Because the Report does not bind the administration to a particular course of action, as does the Plan, it was anticipated that the Report would contain more detail than the Plan. Indeed, the House Committee Report accompanying EEPA (which the Conference Committee adopted) anticipated submission of detailed information to keep the Congress informed of the administration's options for using the SPR. It states, "By requiring a Strategic Petroleum Reserve report rather than a drawdown plan, the Committee intends to assure that the Congress will have all pertinent information regarding the various options available for employing the SPR without requiring the administration to choose, at this time, among those options * * * The report should cover in depth what crises are reasonably foreseeable and include a variety of possible measures for handling them."

The SPR Report delivered to the Congress, however, contains substantially less information than expected. In a brief two

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1/Statement before the Senate Committee on Energy and Natural Resources, May 6, 1982.

and one-half page section, the Report addresses the statutory requirement for an analysis of interruption situations requiring SPR drawdown, and the strategies that could be used for them. Only two scenarios which may result in SPR drawdown are mentioned, and little information is given on what the circumstances are for each one, or on how the SPR would be used. In the first case, for example, a hypothetical "Severe" Case, we do not know how serious this obscure "Severe" case is, nor do we know important details affecting SPR use such as foreign and domestic oil inventories, production, and consumption levels. Furthermore, rather than providing "a description of the strategy or alternative strategies of distribution" which could be used in each situation, as EEPA requires, the SPR Report does not say in either scenario when or how the SPR could be used.

On the same day the SPR documents were released, however, DOE issued a staff paper entitled, "Issues and Analysis on the Use of the SPR." While this document is a compendium of analyses performed by DOE and DOE contractors on SPR-related issues, it does not go much farther than the other documents in supplying information on SPR policy options and strategies to the Congress. This document (1) merely summarizes ongoing research and draws few conclusions, (2) examines only a limited number of variables relating to SPR use, (3) does not link analytical results (e.g. oil price effects of SPR drawdown) with specific SPR use policies, and (4) does not represent DOE or administration policy.

THE ADMINISTRATION'S ARGUMENTS AGAINST COMPREHENSIVE PLANNING ARE UNCONVINCING

The SPR Report alleges that many uncertainties preclude our ability to develop SPR drawdown and distribution strategies. Other administration arguments for avoiding advance planning include the need to preserve Presidential flexibility, and to keep sensitive information secret.

"Uncertainty," in our judgment, is not a valid reason to avoid planning alternative SPR use strategies before we are faced with a serious disruption. First, we would also likely have incomplete information at the outset of a disruption as well as before one. In such a case, advance specification of alternative options could assist decisionmakers in responding more rapidly and effectively to changing conditions. Second, we may never resolve all unknowns; we will inevitably have to develop plans in the face of some uncertainties.

Our past work has shown the administration's legitimate concerns over flexibility and secrecy can be accommodated while still allowing for effective SPR drawdown and distribution planning. Flexibility can be preserved by detailing options for SPR use rather than prescribing a single plan. If an actual disruption occurred, such a plan would serve as a basis for preparing a specific set of action proposals, tailored to the nature of the disruption, and thus preserve flexibility.

The need to keep certain information secret can be addressed by developing effective plans but not releasing sensitive materials to the public. Military contingency plans are continually prepared with sensitive information kept secret. We see little reason why similar procedures cannot be followed for planning SPR use. Indeed, the House Committee Report accompanying EEPA addressed this issue, stating that,

> "The Committee fully recognizes that sections of the report may contain sensitive information and therefore expects that both proprietary information as well as information which may be classified for national security purposes, shall be so identified and may be separately submitted at the same time."

According to DOE's Deputy Assistant Secretary for Energy Emergencies, no classified materials were submitted.

WHY EFFECTIVE SPR DRAWDOWN AND DISTRIBUTION PLANNING IS NECESSARY

Important benefits can be derived from advance SPR use planning. Planning should include both analysis of SPR use strategies and developing drawdown policy options which can effectively counter the serious damage disruptions can cause. While DOE's program and the staff paper mentioned above show that some analysis is being carried out, we see little evidence that drawdown policy options based on the analytical work are being developed.

Among the most important benefits, such advance SPR planning (1) allows informed decisions to be made quickly at the outset of an emergency and (2) provides decisionmakers more information about changing circumstances during a disruption so that adjustments can be made more quickly. Indeed, these benefits have long been recognized by military contingency planners who must continually develop alternative scenarios and response options under extreme uncertainty. Other advantages of advance SPR use planning are that it can help to

- --lay the groundwork for coordinated stock drawdown policies with our allies,
- --reduce "panic" buying that contributes to rising oil prices when an oil supply disruption occurs, and

--deter an oil embargo by demonstrating our resolve and ability to counteract one.

In summary, the advantages of advance SPR use planning outweigh the disadvantages. The SPR documents submitted by the administration, however, are vague and do not contain such plans or the scenarios and response options on which plans could be based as envisioned by the Congress. Development of alternative SPR use scenarios linked to response options should therefore take place as soon as possible.

There are a number of key issues concerning SPR use policy which flow from our analyses, and are discussed in the enclosure, which we suggest Congress consider when evaluating the administration's Plan and Report. These include:

--The SPR Plan asserts that it does not seem desirable or appropriate to establish an automatic "trigger" to determine when or at what rate the SPR should be used. Should such a trigger be used? If not, should a decision to use the SPR be entirely a Presidential choice, or should the Congress be involved in the decision?

--The Plan provides for a maximum 10 percent of SPR oil to be used at the discretion of the Secretary of Energy to alleviate hardship during a severe emergency. Does the Congress agree with the concept of this "set-aside?" Is 10 percent the right amount?

--Under the Plan, SPR oil (including the "set-aside" oil) would be sold at market prices. Should all SPR oil be sold at market prices, or should any distribution policies be invoked other than "to the highest bidder?"

--Recent research has determined that an early drawdown of SPR oil during a disruption can most effectively dampen steep oil price increases. Should SPR oil be used this way, or should it be retained for later in disruptions?

--The SPR Report acknowledges that the SPR could be considerably more effective if its use were coordinated with other consuming nations' oil stocks. Can and should the U.S. try to coordinate stock drawdown policies with these nations to counteract an oil supply disruption?

--Both the SPR Plan and Report note that the Reserve could be used to satisfy U.S. obligations under the International Energy Program (IEP), but give little indication on whether it would be used for this

> purpose. Under what conditions should the SPR be used to support the U.S. commitment under the IEP?

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Because our evaluation was requested within 30 days, we did not request agency comments. However, we provided DOE energy emergency preparedness officials with a draft and discussed their reactions with the Deputy Assistant Secretary for Energy Emergencies. The reactions of DOE emergency preparedness officials and our comments thereon are summarized below.

The officials' main concern was that our report did not mention the DOE staff paper which was published at the same time the President submitted the SPR Plan and Report to the Congress. The DOE officials maintained that the staff paper makes up at least partially for the deficiencies we noted in the Plan and Report by providing results of several disruption scenarios. In addition, they stated that our report implied that DOE was doing no SPR use planning.

We are aware that DOE supports analysis on SPR issues and have made changes to reflect this in our report. Indeed, we know of a number of in-house projects and DOE-funded outside research which are noted in the staff paper. However, we disagree with DOE's assertion that the staff paper supplies the kind of information not included in the SPR Plan or Report requested by the Congress.

First, the staff paper's status is ambiguous. It is not a Presidential submission as are the SPR Plan and Report and so does not carry the same weight. Indeed, the paper does not even represent DOE's position. As is noted in the paper's first paragraph:

> "It is strongly emphasized that no statements contained in the reports, studies and analytical works described herein are to be construed to represent DOE's current position on SPR-use or related issues concerning Administration policy."

Thus, it is difficult to see what value should be placed on the paper aside from the information contained on DOE and contractor projects.

Second, we believe that the staff paper does not go significantly further than the other documents in supplying the information and analysis of policy options and strategies requested by the Congress. As noted previously, EEPA calls for the SPR Report to include:

--foreseeable disruptions,

--descriptions of alternative strategies to
respond to each disruption, and

--the theory and justification underlying
each strategy.

The staff paper merely summarizes ongoing research but draws few conclusions; it examines only a limited number of variables relating to SPR use; and it does not link analytical results to specific SPR use policies. It describes only one disruption which takes place under three different demand and supply elasticity conditions, in three different years, and with three different probabilities of occurence. The paper does not describe alternative response strategies; it simply varies the drawdown from case to case. In addition, because alternative strategies are not discussed, neither are theories or justifications underlying them. The SPR Report explicitly acknowledges that alternative SPR use options have not been developed yet, stating at one point, "* * * [such] questions inevitably lead to several issues which need to be resolved in order to develop the components of an SPR use strategy."

In summary, although the staff paper provides some useful information on DOE's program of analysis, it does not make up for the deficiencies we noted in the SPR Report and SPR Plan.

Other DOE comments were less significant and have been incorporated in this report as appropriate.

J. Dexter Peach
J. Dexter Peach,
Director

Enclosure

ANALYSIS OF THE STRATEGIC PETROLEUM RESERVE DRAWDOWN PLAN AND THE STRATEGIC PETROLEUM RESERVE DRAWDOWN AND DISTRIBUTION REPORT

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ANALYSES OF THE STRATEGIC PETROLEUM RESERVE DRAWDOWN PLAN AND THE STRATEGIC PETROLEUM RESERVE DRAWDOWN AND DISTRIBUTION REPORT

CONGRESS HAS EXPRESSED STRONG INTEREST IN EFFECTIVE SPR DRAWDOWN PLANNING

The Energy Emergency Preparedness Act of 1982 (EEPA) and the Energy Policy and Conservation Act of 1975 (EPCA), as well as congressional reports prepared while considering them, all underscore Congress' strong interest in advance SPR use planning.

Section 154(e) of the Energy Policy and Conservation Act of 1975 (EPCA) first required an SPR Plan to be submitted to the Congress, containing "a Distribution Plan setting forth the method of drawdown and distribution of the Reserve" (section 154 (e)(12)). An SPR Plan, transmitted to the Congress in early 1977, made clear that a decision to use the SPR must be an integral part of a comprehensive plan to respond to energy emergencies.

Neither this SPR Plan nor an October 1979 amendment to the Plan, 1/ however, specified how or under what conditions it would be used (i.e., amount, drawdown rate, and timing of use), or how it would be distributed and priced. The October 1979 amendment maintained that it is infeasible and undesirable to specify in advance the precise conditions in which the Reserve would be drawn down.

Congressional reaction to this approach and statements made in shaping EEPA provide clear signals about Congress' expectations for the latest SPR Drawdown Plan and the SPR Report. The House Committee Report accompanying EEPA, for instance, called the 1979 amendment, "extremely general in its approach to SPR distribution," although "Congress accepted this Plan, despite its shortcomings." The Committee further observed that "to date, little information is available to Congress to allow sufficient oversight of potential SPR distribution or to assure Congress that planning and analysis are adequate." It further asserted Congress' role in SPR drawdown planning by stating that the purpose of the SPR report is "to improve the quality of analysis and information available to Congress and the public."

While the Senate version of EEPA did not originally require the same SPR report, the accompanying Senate Committee Report noted that SPR drawdown planning should

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1/U.S. Department of Energy, "Distribution Plan for the Strategic Petroleum Reserve," Washington, D.C., Oct. 29, 1979.

> "address in advance when the President proposes to use the Strategic Petroleum Reserve, and how he would distribute the oil in a drawdown. The response procedure must also address under what circumstances the President proposes to use the Reserve and define effective distribution methods and drawdown rates."1/

Congress expected more detailed analysis in the SPR Report than in the SPR Plan

EEPA provides that the SPR Report contain more detailed information on SPR use than the SPR Plan. The main reason is that legislation commits the Administration to draw down the Reserve in accordance with the SPR Plan. Therefore, an excessively detailed SPR Plan could reduce the Administration's flexibility in using the SPR during an emergency. EPCA, section 161(b), states that "* * * no drawdown and distribution of the Reserve may be made except in accordance with the provisions of the Distribution Plan contained in the Strategic Petroleum Reserve Plan * * *."

No such legislative requirement binds the administration's drawdown actions to the SPR report. Instead, the focus of the SPR Report was to demonstrate that effective SPR use planning was taking place, without requiring a specific course of action during a drawdown. The House Committee Report emphasized this point, stating that:

> "By requiring a Strategic Petroleum Reserve report rather than a drawdown plan, the Committee intends to assure that the Congress will have all pertinent information regarding the various options available for employing the SPR without requiring the Administration to choose, at this time, among those options."

THE SPR PLAN

The SPR Plan contains a very general discussion on how the SPR would be drawn down during an oil supply interruption. It does, however, specify several key policy decisions on SPR use, notably a rejection of an automatic "trigger" to determine when to use the SPR, and a provision for a 10-percent "set-aside" of SPR oil to be used at the discretion of the Secretary

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1/The Senate Committee Report stated that these elements should be contained in the Comprehensive Energy Emergency Reponse Procedures, which are scheduled to be submitted to the Congress on December 31, 1982.

of Energy. These and other features of the Plan are discussed below as follows:

- --When and how the SPR would be used.
- --Contracting and sales: buyer selection and pricing.
- --Operational capabilities to move SPR oil.

When and how the SPR would be used

The Plan contains little guidance on what circumstances might result in a drawdown of the SPR, and what the drawdown rate would be.

Emphasizing uncertainties involved, the Plan states that "drawdown decisions must be based on estimates of how long the interruption may last, the likelihood of subsequent interruptions, and whether there will be opportunities to refill the SPR between interruptions."

A brief section on drawdown rate indicates that "as a general rule, the presumption will be made that the most efficient allocation of oil over time will be made by the market." However, it also indicates that, depending on "U.S. foreign policy objectives" and other characteristics of the disruption, the Government may make the decision to draw down the SPR at a high or low rate, and to adjust the rate during the disruption.

The objectives given for SPR use are extremely broad, as are the "policy considerations pertaining to SPR use." These objectives and policy considerations are merely stated; they are not tied to decisions on when and how to use the SPR. For example, one of these considerations is "the degree, if any, to which the SPR is to be used to support the U.S. commitment under the International Energy Program." 1/ However, noting that there is no requirement that the SPR be drawn down and used to satisfy IEP obligations, the SPR plan does not give any indication of if or how this "consideration" would influence SPR drawdown decisions.

1/The Congress has expressed interest in this key issue. The Conference Report on S. 1503, "Standby Petroleum Allocation Act of 1982" (vetoed by the President), stated, "Another issue raised by the conferees is what, if any, is the relationship between the SPR and the potential obligations of the United States under the International Energy Agency Agreements."

An automatic "trigger" for SPR drawdown is undesirable

One substantive issue addressed in the SPR Plan is whether a "trigger" should be used as a basis for determining when the SPR should be drawn down and at what rate. The Plan states:

> "It does not seem feasible or appropriate at this time to establish a specific 'trigger' or formula which will automatically determine if the SPR is to be used and at what interval and rate because of the wide range of unpredictable conditions which might characterize an energy supply interruption."

It states that the President will decide when to use the SPR and at what rate.

GAO agrees that the President should have the flexibility to determine if and how to use a vital resource like the SPR in responding to a crisis. In our judgment, it makes little sense to leave the Nation's security in the hands of a pre-determined formula which could not account for the unique circumstances of a particular disruption. However, we are also concerned about a course at the other extreme: that is, leaving the President abundant flexibility but with little information available to him or the Congress on alternative strategies available and their consequences. Clearly, the constructive strategy is to allow the President broad flexibility, coupled with the detailed planning of alternative strategies that allows quick but informed decisions to be made during a crisis.

Contracting and sales: buyer selection and pricing

According to the Plan, the basic method for distributing SPR oil would be price-competitive sale with awards going to the highest bidders. The sale would be open to all interested buyers. The Plan states that "under the most extreme of circumstances," 10 percent of the SPR oil sold in any calendar month may be distributed in a manner at the discretion of the Secretary of Energy. The Plan does not identify, however, what these "extreme circumstances" are. The price of this "set-aside" oil would still be indirectly determined by competitive sale.

This strong endorsement for price-competitive sale is a significant departure from that of the 1979 Plan, which authorized the use of crude oil allocation and price controls for SPR oil, if "required to avoid serious inequities." The current Plan's response to these past regulatory programs is stated at the beginning of Chapter IV:

> "Experience has demonstrated that Government intervention in the marketplace, in the form of allocation and price controls, has a negative impact on our Nation's ability to cope with severe energy supply interruptions. The failure of allocation and price controls * * * has led this Administration to conclude that market mechanisms must be relied upon to respond to severe energy shortages most efficiently and effectively."

Our September 1981 report agreed that there were many problems with past allocation and price control programs. These programs encountered a host of administrative problems and were complex and burdensome to industry. Our audit of these programs, following the Iranian oil shortfall of 1979, characterized the gasoline allocation program as "chaotic" in responding to the crisis.

A pure free-market approach, however, could also have serious drawbacks, as our September 1981 report noted, particularly the hardships caused by high prices. A market-based approach necessarily allocates both SPR and all other oil to users who are willing and able to pay the going price; it cannot guarantee that vital services or exceptional hardship cases would be able to obtain supplies.

The 10-percent set-aside would be of limited use

The Plan addresses the vital services and hardship problems somewhat by providing for a 10 percent "set-aside" of SPR oil to be used at the discretion of the Secretary of Energy.

In our judgment, this modest set-aside would be useful in providing flexibility without causing large inefficiencies in the market. However, its potential to alleviate hardship during a severe emergency is also limited.

First, until the SPR's maximum drawdown capability increases well above its current 1.7 million barrels per day (MMBD) capacity, the maximum allowable size of the 10-percent set-aside (170 thousand barrels per day (MBD)) would be quite small relative to the total oil use. Furthermore, the 170 MBD set-aside would decline to 90 MBD during the second quarter of a disruption and nearly zero during the third quarter as the SPR is exhausted.

Operational capabilities of the SPR drawdown and distribution system

In addition to these policy issues, another question addressed by the Plan is purely logistical--how well can the system respond to an actual disruption? The SPR Plan addresses this issue by describing the physical distribution system's ability to move oil and the procedures that would be followed during drawdown and distribution.

The Plan states that the SPR storage system is designed to make maximum use of private distribution facilities, with the Government supporting industry as appropriate. According to the Plan, the storage configuration provides the capability to distribute the SPR oil through pipelines to refineries or to marine or other terminals for shipment, and the distribution system has sufficient flexibility and redundancy to meet a variety of demands.

Beyond the physical capabilities of the system to distribute the SPR oil, the Plan makes little reference to administrative or managerial capabilities to respond to a shortfall. DOE's Deputy Assistant Secretary for Energy Emergencies, however, told us that more insight into the managerial aspects of the SPR's operational capabilities will be provided in future documents. The first will be the Administration's Comprehensive Energy Emergency Response Procedures Report, scheduled to be delivered to the Congress on December 31, 1982.

The second document is the SPR Distribution Management Manual (DMM). The revised manual will be completed by March 1983, according to the Deputy Assistant Secretary for Energy Emergencies. The manual details an operational methodology for using the SPR in response to an energy emergency. According to the manual,

> "it is a systems integrating tool which bridges the gap between the general policy guidance found in the EPCA and the SPR Plan, and detailed operating procedures contained in office instructions and operating manuals. The manual describes the functions and activities associated with the management of SPR drawdown and distribution. It is intended to provide a comprehensive picture of a generalized response process."

The latest version of the Manual includes a very detailed statement of activities to be undertaken by specific agency officials and the responsibilities of participating offices and individuals, but it does not give guidance on how or when these responsibilities shall be carried out. However, as the introduction to the manual states, "It is not intended to describe the detailed procedures used to deal with the multitude of variables associated with an actual energy emergency. The manual describes what must be done, but not how to do it." One of DOE's planned operational tests of SPR drawdown and distribution will provide a better indication of how well the procedures actually work in practice. The test is scheduled for the first half of

1983. This will be a managerial and administrative functions test to determine the administrative responsiveness to a need for SPR drawdown. While no crude oil will actually be withdrawn in this exercise, DOE will run through the procedures as specified in the revised Distribution Management Manual, with the actual agency officials functioning in the positions and carrying out the responsibilities stipulated in the Manual. The results of the test will be addressed in one of GAO's quarterly SPR reports.

THE SPR REPORT

The SPR Report was required by EEPA to contain (1) a description of the foreseeable situations which could necessitate distributions from the SPR, and (2) descriptions of alternative strategies of distribution (with the theory and justification for each) which could be used to respond to each of these situations.

As we noted earlier, EEPA does not require that the SPR Report commit the administration to any methods or procedures in drawing down the Reserve. Because no such requirement exists, the Report could have contained more detailed analysis of SPR use options than the SPR Plan without constraining the administration's flexibility to use the SPR. However, as we discuss below, the Report contains little useful information.

Congress expected detailed analysis in the SPR Report

The Conference Committee Report provides an indication that the Congress expected detailed analysis of SPR use options, stating that the Report "should cover in depth what crises are reasonably foreseeable and include a variety of possible measures for handling them." It further emphasized the desire to have multiple scenarios and response strategies analyzed, stating that the Report "is also expected to address the alternative strategies for the use of the SPR to handle an interruption of a magnitude substantially greater than the Iranian shortfall, as well as smaller interruptions." Among the other specific items that were asked to be included are:

- --A "thorough discussion" of regional impacts to ensure that the SPR can respond to localized emergencies.
- --Whether the SPR should be drawn down early or late.
- --Whether the oil industry's infrastructure can respond effectively to a long-term drawdown given its present administrative and operational characteristics.

The SPR Report contains far less information than expected

The SPR Report delivered to the Congress contains substantially less information than expected. In fact, it appears to be little more than a bare-bones attempt to comply with the letter of the statute.

The subjects of the Report are addressed in the broadest terms, particularly the "situations" and alternative strategies required by EEPA. Some of these discussions are repeated verbatim in the SPR Plan. The second chapter of the 24 page, two-chapter report is largely a discussion of why comprehensive SPR drawdown planning is infeasible. The result is a report that supplies very little information on how, or whether, we can effectively use the SPR.

Alternative interruption situations and response strategies are inadequate

In a two and one-half page section of chapter I, called "SPR Use Scenarios," the SPR Report addresses the statutory requirement for an analysis of interruption situations requiring SPR drawdown, and the strategies that could be used for them. Rather than the detailed analyses requested by the Congress, the Report presents "some simple scenarios" for "illustrative purposes."

Interruption scenarios are vague

Only two scenarios which may result in an SPR drawdown are mentioned: a hypothetical "Severe" case and a hypothetical "Moderately Severe" case. A third "Mild" case briefly mentioned does not result in a drawdown.

The descriptions of the "foreseeable situations" necessitating an SPR drawdown (required by EEPA, section 6(b)(1)) are extremely vague. Therefore, they give little insight into what types of situations the administration would consider using the Reserve. While the first scenario provides "some of the major features of this 'Severe' case," many important details are omitted. We do not know, for example, how severe this obscure "Severe" case is, nor do we know important details such as foreign and domestic oil inventories, production, and consumption levels.

The "Moderately Severe" case is also vague. Two key variables mentioned, inventory levels and surge production capacity, are described in the broadest terms ("high" or "low"). Although "the time period of the disruption can be closely estimated," according to the scenario, no estimate is given. Little else is provided, including the size of a "Moderately Severe" disruption.

SPR distribution strategies are inadequately described

Section 6(b)(2) of EEPA requires, for each scenario described, a description of the strategy or alternative strategies of SPR distribution which could reasonably be used to respond to each situation. Specifically, this section requires to be included

--the theory and justification underlying each strategy,

--an explanation of the methods which would likely be used to determine the price and distribution of petroleum products from the Reserve in any such distribution, and

--an explanation of the disposition of revenues arising from sales of any such petroleum products under the strategy.

This information is not adequately provided in either of the scenarios where SPR drawdown is considered. The first scenario merely alludes to uncertainties involved in making SPR decisions, and concludes only that "this first scenario represents a case of the most severe circumstances under which use of the SPR would be considered." According to the Report, the second scenario "illustrates how dependent the decision to use the SPR is on the circumstances prevailing at the time of the disruption." It does not specify when or how the SPR could be used (including the specific requirements of section 6(b)(2), mentioned above), concluding only that "The SPR would be one of a number of ways to respond to the shortfall."

How the scenarios could have provided more useful information

A more detailed analysis could have provided the Congress with much more useful information on how the SPR can be used.

This would have required more scenarios to be evaluated than the three extremely general ones in the Report. Each scenario could have simulated, in far greater detail, the circumstances of an interruption where the SPR could be used. Thus, rather than using only a "severe," "moderately severe," and "mild" case, these could have been categories of more specific scenarios.

This type of approach could have demonstrated how the "uncertainties" discussed in the Report influence decisions about SPR drawdown. For example, two similar "moderately severe" scenarios could have been analyzed, each simulating different oil consumption levels. A comparison of the results could have shown how this variable would influence decisions on SPR use. Different SPR use objectives (e.g., safeguard military preparedness, or dampen world oil price increases), could also have been analyzed in the same manner to isolate their effects on an SPR response to an interruption.

In addition to expanding the number and types of scenarios, EEPA specifically allows alternative response strategies for each scenario, rather than a single strategy. Thus, given a particular scenario calling for an SPR drawdown, a strategy using a high initial SPR drawdown rate could be compared with one using a low initial drawdown rate--with the "theory and justification underlying each such strategy," as required by section 6(b)(2).

Such analyses would have provided better insight on how the SPR could be used to deal with specific situations. Furthermore, since the SPR Report is not binding on the administration, as is the SPR Plan, it would not have compromised the administration's flexibility.

The rest of Chapter I contains little new information

Beyond the three scenarios, little other new information is described in Chapter I about SPR drawdown policy. The chapter largely elaborates on the administration's free market philosophy, which is stated in the SPR Plan; reiterates its positions supporting competitive sale of SPR oil and opposing a "trigger" for SPR drawdown; restates some of the administration's statutory obligations under EPCA and EEPA; and repeats other information from the SPR Plan.

Chapter I also lists a number of considerations which should influence SPR drawdown decisions. As with the scenarios, however, they lack the necessary detail to be useful, and are not "operationalized" to show how they would influence SPR drawdown decisions. Many are repeated verbatim from the SPR Plan.

"Uncertainty" is improperly used as an excuse for inadequate SPR drawdown planning

The second and final chapter of the SPR Report entitled, "Decisionmaking Under Uncertainty" essentially argues that uncertainty precludes effective SPR drawdown planning. The Report states that "the strategy development process is beset by a variety of uncertainties which are explored in greater detail in this chapter." It then elaborates on several of these uncertainties, explaining why they complicate SPR drawdown planning.

We do not believe that "uncertainty" is a valid reason to avoid planning alternative SPR use strategies before we are faced with a serious disruption. As we detail below, military planning continually takes place under major uncertainties. Furthermore, as past oil disruptions have demonstrated, uncertainty often exists during emergencies, not just before them. The more information there is on alternative SPR options during the event, the easier it will be for decisionmakers to react to rapidly changing circumstances. The absence of any options will more likely leave judgments about SPR use to ad hoc decisionmaking.

Equally important, we cannot afford to wait until every unknown is resolved before we begin to plan strategies for SPR drawdown. Indeed, we may never resolve all the uncertainties surrounding this complex issue. Having never used the SPR in an emergency, the information is unavoidably limited because there is no previous experience upon which to base future actions. This does not mean, however, that we should not plan ahead for SPR use. Rather, we should do the best we can with what we have; alternative options can be further refined as better information becomes available, as is done in military contingency planning.

OTHER ADMINISTRATION CONCERNS ABOUT SPR USE PLANNING CAN BE ACCOMMODATED

Beyond the concerns over planning under uncertainty, other administration concerns about detailed advance planning are that it could (1) restrict Presidential flexibility in responding to an emergency and (2) expose sensitive information if details of a plan were made public. We believe, however, that the legitimate concerns over flexibility and confidentiality of sensitive information can be adequately accommodated while still allowing for effective SPR drawdown and distribution planning.

The need to preserve Presidential flexibility can be accommodated

Administration officials have stated that a detailed SPR drawdown and distribution plan is unwarranted because the circumstances surrounding a supply interruption are hard to predict, and such a plan would unnecessarily constrain the President's flexibility in dealing with it.

This point was also made by the previous administration in explaining the lack of detail of the October 1979 Amendment to the SPR Plan. Testifying before the House Subcommittee on Energy and Power on November 9, 1979, DOE's former Deputy Assistant Secretary for the Strategic Petroleum Reserve stated,

> "I would like to stress the point that the manner in which we can most productively draw down the Reserve may differ from situation to situation, making the retention of Presidential flexibility and discretion indispensible in order to manage the crisis."

Our September 1981 report addressed this issue, stating that the legitimate need for Presidential flexibility could be preserved by detailing options for SPR use rather than prescribing a single plan. In the event of a disruption, these options could serve as a basis for preparing a specific set of action proposals, tailored to the nature of the disruption, and thus preserve flexibility.

The SPR Report could have been used for detailing such SPR use options. The fact that the Report is nonbinding on future drawdown actions would have further preserved Presidential flexibility.

The need to protect sensitive information can also be accommodated

Our September 1981 report also cited DOE's arguments that making detailed SPR drawdown plans public would reduce their deterrence value, and it could allow adversaries to design methods to overcome SPR "defenses." More recently, DOE's Assistant Secretary for Environmental Protection, Safety, and Emergency Preparedness stated on May 6, 1982, before the Senate Committee on Energy and Natural Resources that "rigid plans * * * if developed and made public, could impair the effective use of the SPR."

We believe, however, that legitimate national security concerns over protection of sensitive information can be better addressed by developing effective plans but not releasing sensitive information to the public. Indeed, alternative military contingency plans are continually prepared with broad outlines of these plans often made public while specific operational plans remain secret. Classified information is also continually shared with appropriate Congressional Committees.

Therefore, the need for secrecy can be accommodated while still allowing for effective SPR drawdown and distribution planning. Indeed, in recommending that EEPA include provisions for the SPR Drawdown and Distribution Report, the House Committee on Energy and Commerce stated,

> "The Committee fully recognizes that sections of the report may contain sensitive information and, therefore, expects that both proprietary information as well as information which may be classified for national security purposes, shall be so identified and may be separately submitted at the same time." 1/

1/Report of the House Committee on Energy and Commerce, #97-585, Part 1, "National Energy Emergency Preparedness Act of 1982," May 24, 1982, p. 12.

According to the Deputy Assistant Secretary for Energy Emergencies, no classified documents were submitted with the SPR Plan and Report.

WHY EFFECTIVE SPR DRAWDOWN AND DISTRIBUTION PLANNING IS USEFUL

In our judgment, important benefits would result from a more comprehensive effort by the administration to plan ahead for SPR use. Among the most important benefits of advance SPR drawdown planning, some of which have been reported in recent GAO work are: (1) it allows informed decisions to be made quickly at the outset of an emergency and in the presence of major uncertainties, and (2) it provides decisionmakers more information to make adjustments during a disruption to accommodate changing circumstances. The existence of these plans, even if the details are not made public, can also assist in coordinating stock drawdown policies with our allies, alleviating panic buying, and deterring oil embargoes.

SPR use planning allows informed decisions to be made quickly under uncertain conditions

As the SPR report notes, many uncertainties exist at the outset of a disruption. It is these uncertainties, however, that are the reason why advance planning is needed.

Many variables must be taken into account during a disruption in order to make informed SPR use decisions. Examples are:

--The severity of the disruption.

--The size of the SPR.

--Size of oil price increases.

--U.S. and foreign oil stocks.

--Actions required by the International Energy Program.

--Political/military actions of other countries.

--Actions of the oil industry.

These and other variables make it difficult to begin analyzing options for action when the disruption occurs, and still arrive at educated and timely decisions. Rather, by analyzing alternative scenarios and response options before a disruption, important information can be developed in advance--lessening the need to rely on ad hoc decisionmaking. This is even more important when considering how quickly circumstances can change during a disruption. Under these conditions, advance planning can provide decisionmakers with useful information rather than forcing them to make decisions with little information about the implications of alternative response options.

Military experiences with advance planning have demonstrated its usefulness

The benefits of advance planning have long been recognized by military contingency planners who continually develop alternative scenarios and response options under extreme uncertainty. The value of this process for the military has important implications for SPR use. Among these benefits, advance planning for military contingencies

--provides an opportunity to identify, organize, and obtain needed resources in advance of an emergency to respond more quickly and effectively,

--helps in establishing and clarifying alternative options to meet objectives, and

--provides a means of training the people who will actually be responding in an emergency so they can respond more quickly and effectively.

Importantly, military planners do not wait for certainty or complete information to begin planning for different contingencies. Since the information will never be complete, they work with the information at hand, knowing that adjustments to plans can be made as more information becomes available. Similarly, SPR use planners can update existing plans as the quality of information improves.

Other advantages of advance SPR use planning

In addition to its usefulness in reducing decisionmakers' uncertainty, advance SPR use planning can have other benefits. Such a planning process could, for example, lay the groundwork for coordinated stock drawdown policies with our allies. The SPR report indirectly alludes to the advantage of coordinated stock drawdown, stating that

> "If the SPR were unilaterally drawn down, the reductions in world (oil) price may be considerably less at the outset of a disruption than if SPR releases were accompanied by immediate releases of foreign stocks."

Research by the Harvard Energy Security Program further supports this, demonstrating that the SPR could exert much greater leverage over rising oil prices during a disruption if its use was coordinated with other consuming nations' stockpiles.

Other advantages of advance SPR use planning are that it can help to:

--Reduce "panic" buying that contributes to rising oil prices when an oil supply disruption occurs. Past disruptions have shown that a major cause of oil price increases is panic buying by oil distributors and consumers in an effort to assure they will have adequate supplies. Knowledge of when the SPR would be used, or at least that effective plans for SPR use exist, could help reduce price increases attributed to panic buying.

--Deter an oil embargo. While detailed operational plans should not be made public for security reasons, public knowledge that contingency plans exist (including broad outlines of these plans) may serve as a deterrent to embargoes. The existence of plans demonstrates our resolve and ability to counteract embargoes and thus may prevent them. Military contingency plans serve a similar purpose, particularly when they are demonstrated through simulations such as war games.

In summary, the advantages of advance SPR use planning, particularly in reducing uncertainty before and during a disruption, outweigh the disadvantages. The SPR documents submitted to the Congress by the administration, however, do not demonstrate that such planning has taken place. In our view, development of alternative SPR use scenarios and response options should therefore take place as soon as possible.

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

B-209176

The Honorable Philip R. Sharp
Chairman, Subcommittee on Fossil
and Synthetic Fuels
Committee on Energy and Commerce
U.S. House of Representatives

Dear Mr. Chairman:

In your May 21, 1982 letter, you asked that we determine the consensus, if any, on the oil price and economic effects of supply disruptions in the absence of U.S. Government intervention. You also asked that we assess the adequacy of research in this area. This report responds to that request.

Sincerely yours,

J. Dexter Peach

J. Dexter Peach
Director

REPORT BY THE UNITED STATES
GENERAL ACCOUNTING OFFICE

OIL SUPPLY DISRUPTIONS: THEIR PRICE AND ECONOMIC EFFECTS

DIGEST

Oil supply disruptions, such as the 1973-74 Arab oil embargo and the 1979 Iranian production shutdown, suddenly remove oil from the world market and cause oil prices to rise. The administration is committed to letting the world oil market determine the price of oil during supply disruptions, permitting the price to rise without restraint by the Federal Government. Expressing concern about how high these prices may go in possible future disruptions, Representative Philip R. Sharp, Chairman of the Subcommittee on Fossil and Synthetic Fuels, House Committee on Energy and Commerce, asked GAO to determine the consensus, if any, on the oil price and economic effects of supply disruptions and to assess the adequacy of research in this area.

GAO's analysis showed that disruptions invariably raise oil prices. If oil prices happened to be falling before the disruption, they would rise or at least fall less rapidly. Oil prices increase in a disruption because production is reduced. This shrinking of oil supplies allows producers to charge more for their oil. The price increase in the 1979 Iranian oil disruption demonstrates that oil prices may increase steeply even if there is enough excess capacity to replace most of the lost production. As experienced in past disruptions, inventory accumulation exacerbates the shortage and price increase.

SCOPE AND METHODOLOGY

GAO used the only three currently available models which focus on the behavior of oil prices in a disruption. These models were developed by Knut Mork of the University of Arizona; Glenn Hubbard and Robert Fry of Harvard University; and GAO, based on principles and estimates of Philip K.

Verleger's model. The models were used, in combination with GAO's analysis of past disruptions and other research, to assess the price and economic effects of world production capacity losses of (1) 3 million barrels per day, a small case, (2) 10 million barrels per day, a moderate case representing the loss of Saudi Arabia or several smaller producers, and (3) 19 million barrels per day, a shutdown of the entire Persian Gulf. Disruptions were assumed to last one year and to take place during a period of modest economic growth.[1] GAO examined these effects under both slack (abundant excess production capacity) and tight (little excess production capacity) market conditions as well as with and without drawdown of the U.S. Strategic Petroleum Reserve.

HOW HIGH MAY PRICES GO?

The models show that disruption size (amount of lost production), market tightness (the percent of available production capacity in use), and what happens to oil inventories govern the severity of oil price increases in disruptions. The figure on page iii shows what happens to contract oil prices (the price charged for oil sold under long-term contract) in a 1983 disruption. Prices rise swiftly and generally reach their peak after the disruption is over. Increases are temporary as long as lost production is fully restored and no other production cutback occurs. Because of the similarities in models' oil price results, those presented here are primarily from the GAO model. However, any significant differences in the other two models' results are noted.

Disruption size

The disruption size (amount of lost production) is the single most important factor determining price increases. Prices rise more than proportionally as disruption size increases. This is shown in the figure on page iii. In a moderately slack market, the GAO model produced the following price increases over the $31 per barrel base:

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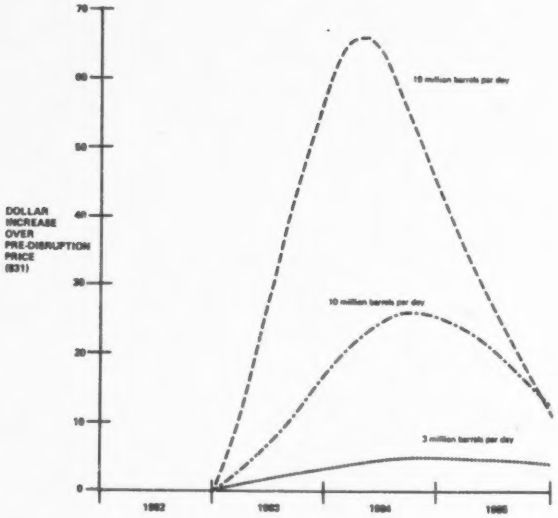
[1] Economic growth in the base case ranged from 2.6 to 4.1 percent, depending on the model.

CONTRACT PRICES IN 3, 10 AND 19 MILLION BARRELS PER DAY
DISRUPTIONS UNDER BLACK MARKET CONDITIONS



--A 3 million barrels per day disruption results in modest price increases, temporarily raising contract crude oil prices by up to $6 per barrel at the peak. Spot prices (the prices paid for oil exchanged on a day-to-day basis) could rise by more than $7 per barrel at the peak.

--A 10 million barrels per day disruption could temporarily raise contract oil prices by about $27 per barrel, while spot prices could rise by about $37 per barrel at the peak.

--A 19 million barrels per day disruption could raise contract oil prices by about $70 per barrel, while spot prices could temporarily rise by more than $100 per barrel.

Caution is called for in interpreting the results of the 19 million barrels per day disruption, however. Market relationships may break down under such severe conditions, making models inappropriate for measuring price effects.

Market tightness

Tighter oil markets lead to higher prices in all disruption scenarios. In GAO's 10 million barrels per day case, increasing the production-to-capacity ratio (that is, the degree of market tightness) from 65 to 75 percent raised spot prices at their peak by an additional $16 per barrel or 50 percent. The larger the disruption, the greater the price rise.

Oil inventories

How oil companies utilize their oil inventories

Examination of past disruptions reveals that oil companies accumulate inventories--a key factor pushing prices up. Inventory buildup is caused by expectations of rising prices and uncertainty over whether the disruption may worsen. The volume of inventories accumulated accelerates steeply with the disruption size. For example, in the 10 million barrels per day disruption case, private inventory buildup increased prices by nearly $8 per barrel.

Strategic Petroleum Reserve drawdown

Drawing down the U.S. Government's oil inventory (the Strategic Petroleum Reserve) can reduce price increases somewhat. In GAO's 10 million barrels per day disruption, drawdown at its current maximum rate made an 8 percent or $5 per barrel price difference. The Reserve's current size and maximum drawdown capability of 1.7 million barrels per day limits its leverage over prices in large disruptions. However, when the Reserve reaches a level of 540 million barrels, maximum drawdown capability will more than double. In a 10 million barrel per day disruption, drawdown at the maximum rate would lower the average spot price increase for 1983 by 17 percent.

CONSUMER OIL PRICES

Consumer oil prices respond sluggishly to disruptions, peaking more than 6 months after the disruption's end. Heating oil price increases are generally the same as those for gasoline.

- --Gasoline prices could rise by as much as 25 cents per gallon at their peak in a 3 million barrels per day disruption.
- --In a 10 million barrels per day disruption, gasoline prices could temporarily rise by as much as $1.28, depending on the market tightness at the disruption's onset.
- --A 19 million barrels per day disruption could raise gasoline prices by $2.20 per gallon at their peak, representing an increase of about 170 percent.

MACROECONOMIC EFFECTS OF SUPPLY DISRUPTIONS

Oil price shocks accompanying supply disruptions hurt the U.S. economy. GAO's research shows that macroeconomic effects would be modest in small disruptions and severe in a 19 million barrels per day or Persian Gulf disruption. The adverse economic effects are temporary with one exception. There would be a permanent, one-time loss in the gross national product (GNP). The models' economic results are not as similar as their oil price results. Thus, depending on which is more appropriate, either ranges of model results or the maximum effects are presented here.

Inflation

Many researchers have cited oil disruptions as one cause of increased inflation in the last decade. All models showed small inflation increases by one-half a percentage point or less in the 3 million barrels per day disruption. In the 10 million barrels per day disruption, the inflation rate could increase by as much as 2.6 percent at the peak. The Persian Gulf disruption causes severe inflation increases from about 3 to 11.4 percent (depending on the model) at the peak.

Economic growth

Oil price shocks reduce economic growth during the disruption year and the year following. Much of the economic literature considers oil supply disruptions to have contributed greatly to the recessions in 1975 and 1980. The three models show that small disruptions have modest effects, with the 3 million barrels per day case reducing the economic growth rate by no more than 0.4 percentage points at its peak. The 10 million barrels per day disruption could temporarily reduce real GNP growth by as much as 3 percentage points, representing a loss of about $99 billion. The 19 million barrels per day disruption would have severe impacts. The real GNP growth rate could be temporarily reduced by over 13 percentage points, according to the model showing the largest economic effects. This would mean, for example, that if GNP would have grown at an annual rate of 3 percent without the disruption, it would decline at a rate of 10 percent with the disruption. This growth reduction represents a peak annual GNP loss of $415 billion. Although the growth rate generally catches up within two years of the disruption's end, a permanent loss in GNP remains due to lost investment.

Unemployment

The models show that oil price increases will generally raise unemployment by less than one percentage point in the 3 and 10 million barrels per day disruptions. However, a one percentage point increase represents a loss of over one million jobs. In the Persian Gulf disruption, peak increases in the unemployment rate range from about 1 to 6 percentage points, depending on the model.

POLICY IMPLICATIONS

GAO's research shows that market tightness and oil inventory behavior are important factors determining the size of the oil price increase in a disruption. U.S. Government actions in these areas could help moderate disruption-induced price increases. In advance of a disruption, the Government could help maintain market slackness and encourage the industry to hold adequate oil inventories. During a disruption, the Government could encourage private inventory drawdown or could draw down the Strategic Petroleum Reserve.

KEY AREAS WHERE ADDITIONAL RESEARCH IS NEEDED

Key areas for additional research concerning the effects of disruptions include: (1) the effects of large disruptions such as a loss of the entire Persian Gulf, (2) the effects of and ways to reduce private stock buildup during disruptions, and (3) government policies to minimize the economic costs of disruptions. GAO's current emergency preparedness research includes an assessment of the costs and benefits of government options for encouraging private companies to hold emergency stocks. Private stockpiling before disruptions would help reduce stock buildup during disruptions.

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ABBREVIATIONS

CPI	Consumer Price Index
GAO	U.S. General Accounting Office
GNP	Gross National Product
MBD	Thousand barrels per day
MMBD	Million barrels per day
OPEC	Organization of Petroleum Exporting Countries
SPR	U.S. Strategic Petroleum Reserve

CHAPTER I

INTRODUCTION

BACKGROUND AND OBJECTIVES

Oil supply disruptions in the 1970s dramatically increased oil prices and hurt the economies of the United States and other oil-consuming nations. In the year following the drop in world oil production resulting from the 1973-74 Arab oil embargo, official crude oil prices for Arab light nearly tripled. In the two years following the 1979 Iranian oil disruption, the price of imported crude oil more than doubled. By increasing inflation and unemployment and lowering economic growth, both of these price shocks severely damaged the U.S. economy.

Current slackness in the oil market, with the associated oil price decline, reduces the consequences of a disruption, but under most circumstances it does not reduce the likelihood of a disruption occurring. Crude oil supply disruptions can result from a wide variety of circumstances, including politically inspired embargoes or intentional production cutbacks as well as production shutdowns due to internal political problems, terrorist activities, or regional wars. Declining oil prices and thus oil revenues could destabilize third-world oil-producing nations, thereby increasing the likelihood of a disruption. In addition, while non-OPEC (Organization of Petroleum Exporting Countries) production continues to rise, over one-quarter of the world's oil supply is still produced in the politically volatile Middle East and North Africa. Thus, the probability of disruptions to the world's oil supply remains high.

U.S. oil imports have dropped dramatically in the last few years, but we still import nearly one-third of our oil, so the Nation remains vulnerable to periodic supply disruptions. Also, in an uncontrolled market, oil prices are set at the world level. Thus, even if we imported no oil, the Nation would still be subject to a disruption's price effects. Furthermore, U.S. allies continue to rely on imported oil and remain vulnerable to supply disruptions.

By vetoing legislation renewing emergency oil allocation authority (S.1503), the administration re-emphasized its commitment to rely on the free market to allocate and price oil during supply disruptions. Reliance on the free market means that oil prices would rise until demand for oil fell to a level equal to the diminished oil supply. What is unclear is how much U.S. oil prices would increase using that strategy.

In his May 21, 1982, letter to us, the Chairman of the Subcommittee on Fossil and Synthetic Fuels, House Committee on Energy and Commerce, expressed concern about how high oil prices would rise during oil supply disruptions in the absence of any government intervention (see Appendix III). He requested that we do the following in the context of free market pricing:

- Identify and assess the adequacy of research on oil price effects of supply disruptions;
- Determine the consensus, if any, on the effect that shortages have on U.S. oil prices both during and after a disruption;
- Determine the consensus, if any, on the effects of price shocks on the U.S. economy; and
- Identify any key questions that remain in addressing how high prices may rise during shortages.

This report is our response to the Chairman's request.

METHODOLOGY AND SCOPE

The study was divided into three phases: (1) identifying relevant research, (2) identifying and using models to measure the oil price effects of disruptions, (3) using models to determine the economic effects of shortages.

The first phase of the study entailed a literature search and numerous interviews with staff of government agencies, private organizations, and academia. We also attended a major industry conference on modelling the effects of oil supply disruptions. We identified numerous studies on the economic impacts of supply disruptions. However, rather than explicitly determine the oil price effects, most of them assumed a price increase and measured its economic effects.

In the second phase of the study, we identified and used the only three models that explicitly measure oil price effects of supply disruptions. After assessing these models' technical adequacy and the validity of important assumptions, we asked the model authors to run their models with our disruption scenarios and assumptions. Two of the authors responded to our request. The third model did not exist in a form where it could be easily rerun, so we formulated our own model based on the author's principles, some of his estimates, and his advice. This model consists of seven equations and is based on statistical relationships between elements in the oil market. It appears in Appendix I and is referred to as the GAO model. After obtaining comparable results, we varied assumptions on initial oil market conditions to determine how they affect the size of the price shock. Since the models estimate world crude oil prices, we converted these estimates into U.S. crude and product prices. Our conversion method is described in Appendix II.

The third phase of the study used the three models to measure the economic effects of the price shocks. Two of the models have the rest of the economy built in, while the third contains only the oil sector. To measure economic effects of the prices predicted by the third model, we entered our prices into Data Resources Inc.'s U.S. macroeconomic model. Our audit work was conducted in accordance with generally accepted government auditing standards.

The models

The models we used to measure oil price effects were developed by:

(1) Knut Mork of the College of Business and Public Administration at the University of Arizona;[1]

(2) Glenn Hubbard/Robert Fry of the John F. Kennedy School of Government at Harvard University (referred to here as the Hubbard model); and

(3) GAO, based on principles and estimates from Philip K. Verleger's model developed at Yale University (referred to here as the GAO model).

All three models are built on the statistical relationships between various energy and economic variables over the last decade. The models are computerized for ease of changing assumptions and disruption scenarios.

Models measure price effects through the relationship that prices have with either the ratio of production to production capacity, or the ratio of expected to actual production. The former relationship models a disruption by lowering production capacity. The resulting higher ratio increases prices. The latter lowers actual production, increasing the ratio and thus prices.

There are important differences among the models. (1) Both Mork's and Hubbard's models have linking macroeconomic sectors. Since GAO's does not, it is missing the feedback effect of lower economic growth caused by the price shock, which lowers oil demand and then prices. (2) The three models produce results for different time periods. Mork's model is annual, Hubbard's is quarterly, and GAO's is monthly. (3) Hubbard and GAO explicitly model private oil stock behavior during supply disruptions. Mork's model does not do so and must be adjusted for inventory buildup to avoid understating the size of the shock.

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[1] Mork, Knut. "What If We Lost the Persian Gulf?" Crisis in the Economic and Financial Structure. Edit. Paul Wechtel. (Lexington, Mass.: Lexington Books, 1982).

Mork's model produces a larger price shock in 1983 than the other two models. Since Mork's model is annual, we would have expected it to have the lowest price shock, because averaging the shock over a year reduced the price peak. However, his 1983 price shock is higher because price effects are concentrated in the disruption year.

The above-mentioned factors account for some of the differences in model results. Each model represents a unique view of how and the extent to which numerous factors affect the movement of oil prices during a disruption.

Limitations on using models to measure the effects of supply disruptions

Some cautionary words about using models to predict the effects of future supply disruptions are in order. Every supply disruption is different, and it is impossible to model the effects of every possible combination of circumstances. Model results apply to a given disruption only insofar as the assumptions about the size and duration of the disruption, and the oil market and economic conditions at the outset, are comparable.

Another caution about using models to predict effects of future supply disruptions is that one cannot be certain that past relationships in the oil market, which have been used to estimate the models, are still present. Model results will be good predictors only if future relationships are like those in the past. In fact, we state later that the models may not be appropriate for measuring the effects of severe disruptions because oil market relationships, upon which the models are based, may change under these circumstances.

Models also do not take into account factors that cannot be quantified such as government responses to disruptions. Thus, they cannot fully explain the price response in any given disruption.

Because of these limitations, model results should be interpreted as indicating the direction and magnitude of effects rather than their precise size. Wherever possible, we relate model results to analysis of others' research and past disruptions. Furthermore, since certain assumptions can greatly influence results, we modelled additional scenarios to test how sensitive the results were to alternative assumptions. These alternatives included variations in market tightness and use of the U.S. Strategic Petroleum Reserve (SPR).

THE DISRUPTION SCENARIOS

Disruption sizes

The three world disruption scenarios we modelled were:

(1) 3 million barrels per day (MMBD) production capacity loss, a small case,

(2) 10 MMBD capacity loss, a moderate case, and

(3) 19 MMBD capacity loss, representing a shutdown of the entire Persian Gulf.

A 3 MMBD capacity would be equivalent to the shutdown of two small producers such as Qatar and the United Arab Emirates. This scenario, a fairly small loss in today's glutted market, is the most probable of the three.

The 10 MMBD capacity loss could occur with the shutdown of either Saudi Arabia or a number of smaller producers, such as Iran and Iraq, Kuwait, and the United Arab Emirates. This scenario is less likely than the 3 MMBD loss but is plausible.

The 19 MMBD capacity loss implies the complete loss of Persian Gulf oil. This scenario is the least probable since it would require a total loss of production in the Gulf or the closing of all straits and pipelines. A plausible scenario for this loss would be a major Middle East war.

In all disruptions, capacity or production (whichever the model uses) for the disrupted countries was removed from the world oil market. Thus, we are modelling a true production loss rather than an embargo against the United States, where some of the oil could be sold elsewhere.

Timing and duration

The disruptions were assumed to occur on January 1, 1983, and last for one year. The occurrence in 1983 is incidental in that we did not attempt to predict and simulate energy and economic conditions for this time. We assumed market conditions were similar to those in mid-summer 1982. We chose a one year disruption since Mork's model is annual and could not accept a shorter disruption. At the disruption's end, capacity or production was regained in equal increments over the following two years.

SPR drawdown

Oil price effects of disruptions could be influenced by using the SPR. We made the following assumptions about average SPR fill and drawdown during the disruption year:

Disruption case	Average fill rate (thousand barrels per day)	Average maximum drawdown (thousand barrels per day)
no disruption	200	0
3 MMBD	0	0
10 MMBD	0	0
10 MMBD	0	673 [a]
19 MMBD	0	673 [a]

---

[a] The maximum quarterly drawdown rates during the disruption year are: 1st quarter-1.7 MMBD, 2nd quarter-900 MBD, and 3rd quarter-90 MBD. These are the maximum rates now possible. Drawdown stops after three quarters due to stock depletion. The normal SPR fill rate was assumed in the year after the disruption.

Prior to modelling, we asked the Department of Energy's Deputy Assistant Secretary for Energy Emergencies to enunciate the agency's policy on SPR fill and drawdown during disruptions. He stated that these policies had not yet been decided.[2] In the absence of any explicit administration policy at that time, we chose to discontinue fill during all disruptions. The last administration stopped filling the SPR during the 1979 Iranian oil disruption.

We also assumed that the SPR would not be drawn down in the 3 MMBD disruption and would be drawn down at the maximum rate in the 19 MMBD disruption. Since it is most uncertain what would be done in the 10 MMBD case, we modelled both no drawdown and maximum drawdown. Selecting the two extremes demonstrates the maximum difference SPR use can make. The maximum drawdown rate is set at the highest rate physically possible. This rate changes over the course of drawdown, which is reflected in the monthly and quarterly models. The average drawdown over the course of the disruption year was assumed to be 673 MBD, while quarterly drawdown ranges from 1.7 MMBD for the first quarter to 0 in the fourth quarter.

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[2] Subsequent to our modeling efforts, P.L. 97-229 was passed and required a fill rate of 300 MBD unless the President found that such a rate was not in the national interest. The minimium required fill rate, subject to the availabilty of appropriated funds, is 220 MBD. As long as the maximum drawdown rate remains at 1.7 MMBD, the higher fill rate would only modestly increase the price effects of SPR drawdown. As of the four week period ending December 17, 1982, the SPR was being filled at 192 MBD, a level which is closer to our assumed 200 MBD rate.

Private oil stocks

Private stock behaviors are determined within Hubbard's and GAO's models. Mork's model was at first run without any stock changes, and was run again with the stock changes produced by Hubbard's model.

OIL MARKET AND ECONOMIC CONDITIONS AT THE OUTSET OF DISRUPTIONS

Market tightness

We chose to model our disruption scenarios under both loose and tight market conditions. The tighter the market, the lower the availability of replacement oil, and the larger the price shock. Market tightness is defined as the level of oil demand or production[3] relative to production capacity. The larger the ratio, the smaller amount of unused capacity, and the tighter the market. Our loose market conditions reflect the mid-summer 1982 market since that was the most current data available. At the outset of the disruption, OPEC was assumed to be producing at about 65 percent of maximum sustainable capacity.[4] Thus, substantial unused capacity was available to replace disrupted production. Our tight market case assumed that OPEC was producing at about 75 percent capacity at the start of 1983. To put this assumption in perspective, prior to the 1979 Iranian oil cutoff, OPEC was producing at over 80 percent of maximum sustainable capacity, which experts consider an unusually tight market.

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[3] In the models, production is set to equal oil demand, which is defined as oil consumption plus inventory change. Both production and demand are used, depending on the model, to measure how much of available production capacity is being used.

[4] Maximum sustainable capacity is the maximum production rate that can be sustained for several months. Market tightness grew over 1983 in Hubbard's control case to 70 percent because of growth in world oil demand. This increase tended to enlarge Hubbard's price effects relative to the other model's.

The U.S. economy

We assumed that the disruption would take place during a period of modest economic growth. Since modelling a supply disruption during a recession would in our judgment unduly minimize the disruption's price and economic consequences, we assumed a moderate economic recovery in 1983. These economic assumptions had already been developed by the Energy Modeling Forum in connection with another study and were being used by both Hubbard and Mork.[5] Gross National Product (GNP) growth in 1983 ranged from 2.6 to 4.1 percent in the Hubbard and Mork models--as opposed to being identical--because economic growth is not an input but is determined by the model.

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[5] The Energy Modeling Forum at Stanford University achieved similar economic growth rates by standardizing economic policy inputs. The Federal Reserve Board is assumed to allow the money supply to grow slightly above the target range in the year preceding the disruption. Monetary policy becomes more restrictive in subsesquent years. Administration proposals on curtailing non-defense spending and increasing the military budget are assumed to be implemented. Federal expenditures, as a percent of GNP, drop from about 23 percent in 1983 to 22 percent in succeeding years. Federal receipts as a percent of GNP drop from 19.7 percent in 1983 to 19.6 percent in succeeding years. No additional Federal revenue-raising policies beyond the tax provisions of the economic recovery and tax act are assumed. These policies do not change in the disruption scenarios.

CHAPTER II

OIL PRICE EFFECTS OF SUPPLY DISRUPTIONS

Oil prices increase in a disruption because production and production capacity are reduced, allowing producers to charge more for their oil. A disruption would raise oil prices regardless of market conditions at its outset. If oil prices happen to be falling before that disruption, they would rise or at least fall less rapidly. Prices could rise steeply even if the market has enough excess capacity to replace most of the lost production, as demonstrated in the 1979 Iranian oil cutoff. Iranian oil production dropped by about 5.7 MMBD between September 1978 and January 1979, the months with their highest and lowest production. Excluding Iran, OPEC had about 4.2 MMBD of excess production capacity in September, 1978. This means that OPEC alone had the capacity to make up all but 1.5 MMBD of Iran's lost production, yet contract oil prices nearly doubled in the year following the disruption.

Past research on disruptions shows that oil prices spiral up in a process often referred to as "price ratcheting." Disruptions tighten the oil market, raising spot market prices (the prices paid for oil exchanged on a day-to-day basis). Expectations of rising prices induce inventory buildup, further tightening the market and raising spot prices. Contract prices, or the prices charged for oil sold under long-term contract, lag behind and this sluggish response forces all of the adjustment to reduced supplies into the spot market, driving spot prices higher than contract prices. Eventually, contract prices increase to reflect higher spot prices. In the long run, the contract price increase causes consumers to change their consumption patterns and lower their oil demand, eventually causing prices to drop. However, prices may not return to their pre-disruption level because production may not be fully restored or may be reduced to maintain higher prices.

SUMMARY OF OIL PRICE RESULTS

Figures 1 and 2 summarize GAO's oil price results. Because of the similarity in models' oil price results, figures show only GAO's results. Any significant differences are noted in the text. Figures 1 and 2 show peak additions to spot and contract prices under different disruption scenarios and market conditions, with and without SPR drawdown. Spot prices generally peak in the beginning and contract prices at the end of the year following the disruption. As expected, spot prices rise substantially above contract prices. The price results figured here and elsewhere in this chapter show that disruption size, market tightness, and oil stocking behavior are important factors determining how high oil prices will rise during supply disruptions.[1] The severity of the price shock accelerates steeply with disruption size. Although slack market conditions minimize price effects, a 3 MMBD disruption could still temporarily raise contract crude oil prices by up to $6 per barrel (see Figure 2). As shown in Figure 2, a 10 MMBD disruption could nearly double contract oil prices. A Persian Gulf disruption, of course, would cause even more severe price shocks, although the increase would be partially moderated by the accompanying recession-induced drop in oil consumption. However, those models may not be appropriate for measuring so severe a disruption because basic oil market relationships may break down.

As shown in Figures 1 and 2, a disruption in a tighter oil market would increase prices in every case. Furthermore, the larger the disruption, the greater the difference increased market tightness makes.

Private stock behavior and SPR drawdown can also make a difference in how high oil prices rise during a disruption. Drawing down private stocks and the SPR could reduce oil price increases.

MODEL CONSENSUS

The three models we used to analyze the price effects of disruptions generally agree on the timing and severity of price shocks. Spot prices peak higher and sooner than contract prices, with spot prices generally peaking after the disruption has ended. The Hubbard and GAO models produce very similar results in the 3 MMBD disruption, differing by only 57 cents at their peak. In the 19 MMBD disruption, the models' prices differ by only $10.00 or 15 percent at their peak.

GAO's and Hubbard's models produce fairly similar results because some of their differences offset each other. Hubbard's model produces slightly higher price increases. All other things being equal, the lack of feedback of lower economic growth and oil consumption and the monthly frequency would tend to give the GAO model larger price increases. However, in Hubbard's model, market tightness grew over 1983 in the control case because of growth in world oil demand. This increase tended to enlarge Hubbard's price effects relative to GAO's.

Because of the similarities in GAO's and Hubbard's oil price results, figures show primarily GAO's. We do not present Mork's

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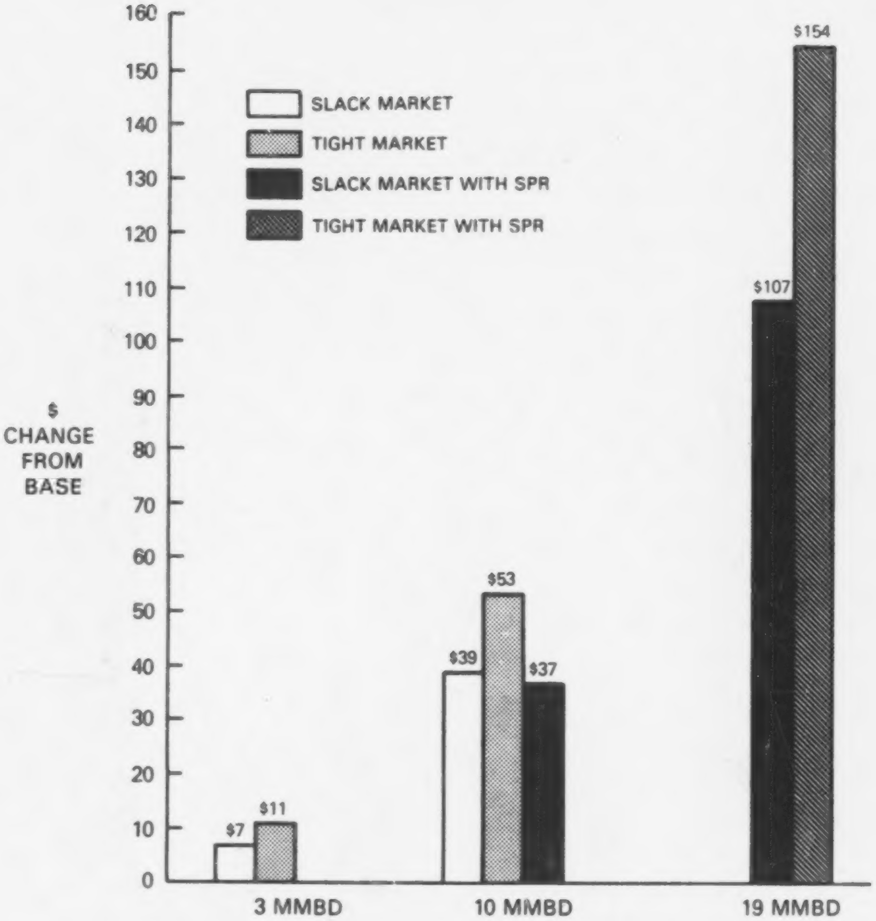
[1] The base price was $30.90.

FIGURE 1

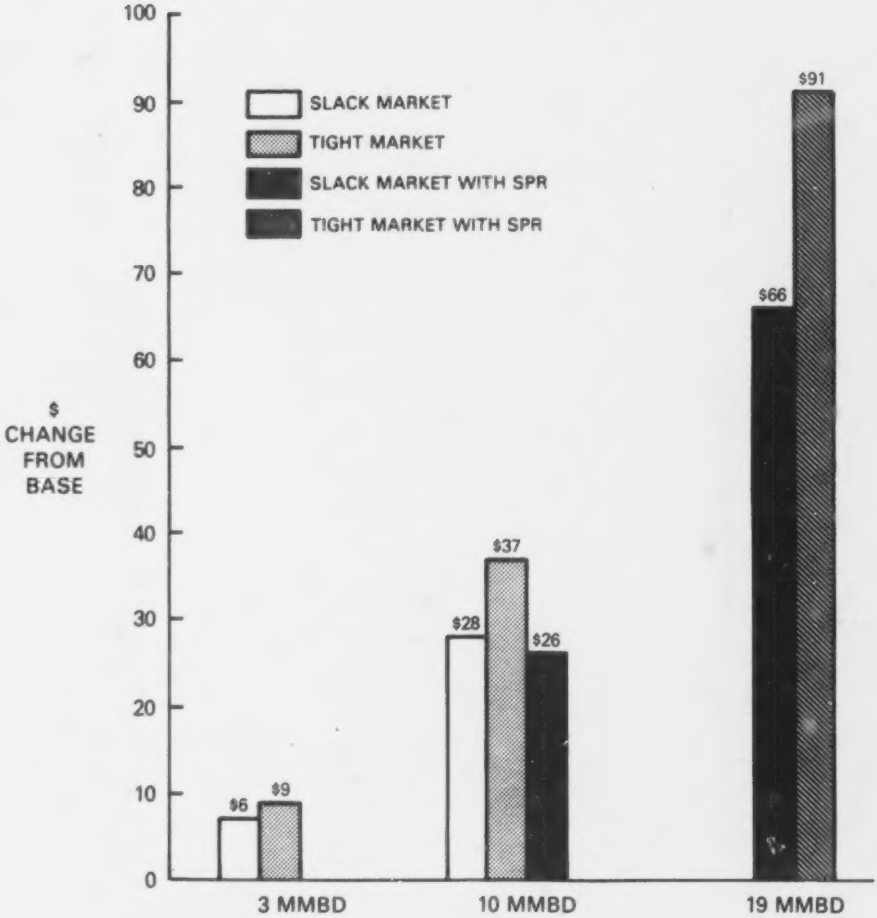
PEAK ADDITIONS TO SPOT PRICES CAUSED BY OIL SUPPLY DISRUPTIONS1/ (GAO MODEL)



1/THESE FIGURES ARE BASED ON QUARTERLY RESULTS. UNLESS OTHERWISE SPECIFIED, SPR DRAWDOWN IS NOT INCLUDED. IN THE CASES WHERE SPR USE IS SPECIFIED, DRAWDOWN IS AT THE MAXIMUM PUMPING RATE.

FIGURE 2

PEAK ADDITIONS TO CONTRACT PRICES CAUSED BY OIL SUPPLY DISRUPTIONS1/ (GAO MODEL)



1/THESE FIGURES ARE BASED ON QUARTERLY RESULTS. UNLESS OTHERWISE SPECIFIED, SPR DRAWDOWN IS NOT INCLUDED. IN THE CASES WHERE SPR USE IS SPECIFIED, DRAWDOWN IS AT THE MAXIMUM PUMPING RATE.

price results here because his model is annual and does not show the timing of price increases as well as the other models. Mork's model is more useful for determining long-term price and economic effects.

The remainder of this chapter discusses in detail oil prices during past disruptions and presents model results.

CRUDE OIL PRICES IN SUPPLY DISRUPTIONS

Spot prices in past disruptions

Spot prices, the prices paid for oil exchanged on a day-to-day basis rather than sold under a long-term contract, rise quickly at the outset of supply disruptions. The amount of crude oil sold on the spot market has varied from practically none under normal circumstances to 25 percent of all sales during the 1979 Iranian oil disruption, as reported by trade journals. Although only a small amount of oil is usually traded on the spot market, spot prices signal market changes. Their sensitivity to supply and demand changes comes from refiners making day-to-day transactions for immediate needs in this market.

Spot prices rose at the outset of both the Arab oil embargo and the 1979 Iranian oil shutdown. Over the first few months of the Arab oil embargo (October to December 1973), the Rotterdam spot price for Arab light oil rose about 500 percent. From November 1978, when oil field strikes began in Iran, to March of 1979, when exports resumed, the spot price of Arab light oil nearly doubled.

Researchers have offered a variety of explanations for this spot price behavior. The primary one is that lower supply exacerbated by stock building forces spot prices up. Danielson, Professor of Economics at the University of Georgia, suggests that spot prices increase because of actual and anticipated refined product shortages and rising product prices. Oil demand remains high or grows because of the initial inflexibility of consumption rates and inventory speculation.[2] Verleger emphasizes the role that stock accumulation, at all levels, plays in driving up spot prices.[3] The combination of expected supply shortages and high demand sends spot prices soaring.

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[2] Danielson, Albert L., "The Role of Speculation in the Oil Price Ratchet Process," Resources and Energy, 1979, p. 256.

[3] Verleger, Philip K., Oil Markets in Turmoil. Ballinger Publishing Company, 1982, Cambridge, Mass., pp. 89-122.

Contract prices in past disruptions

We assumed contract prices to be the official prices that producers charge for oil sold under long-term contract.[4] Various oil industry sources estimate that 90-95 percent of crude oil is normally sold under contract. This percent is reduced during disruptions as oil sales are diverted to the spot market.

The nature of contracts changed dramatically during the 1979 Iranian oil supply disruption, making prices more volatile. In many cases, 6-month and 1-year contracts were shortened to 90 days or less and credit terms were often reduced from 90 to 30 days. Some producers imposed price increases retroactively. Oil market tightness resulting from the disruption enabled producers to make these changes. In contrast, under current slack market conditions, oil buyers have greater leverage and some producers charge below their posted oil prices.

Sharp rises in new contract prices are evident in past disruptions. The official sales price for Arab light, including premiums, rose from about $3.00 per barrel in September of 1973 to about $12.00 in January of 1974. As a result of the 1979 Iranian oil supply cut-off, the official price of Mideast light crude rose from $12.70 in the fourth quarter of 1978 to about $24 in November of 1979, when spot prices peaked. Official prices continued to rise until they peaked at $34 per barrel in the last quarter of 1981.

Two important observations by researchers on contract price behavior during disruptions are that:

--contract prices respond sluggishly to spot market changes and continue to catch up long after the disruption is over, and

--after contract prices peak, they may not return to their pre-disruption level.

Both Verleger and Hubbard state that contract prices follow spot prices upward with a lag. We identified four major causes for contract prices' sluggish response in disruptions:

(1) some contracts may not allow immediate price changes,

(2) OPEC sets prices at quarterly meetings,

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[4] The contract price does not include discounts or premiums, and insurance and transportation costs.

(3) OPEC may not want to raise prices so high that they may have to reduce them later, and

(4) Saudi Arabia may increase production temporarily to restrain prices. One reason for this is that adverse effects on industrial economies could reduce their real returns on foreign assets. In addition, their vast oil reserves give them an incentive to prevent price increases sharp enough to encourage the development of alternative fuels.

Because contract prices are slow to respond to spot price changes they continue to rise long after the disruption ends. This was evident in the Iranian disruption, when contract prices rose more than one-third over the two years after spot market prices peaked.

After contract prices peak, they may drop but not to the pre-disruption level. The long-term quadrupling and doubling of contract prices in the Arab oil embargo and Iranian cutoff, respectively, demonstrate that prices may not drop to their pre-disruption level. One reason for this is that production may not be fully restored as was the case with Iran after the 1979 disruption. Another possible explanation for this phenomenon is that production may be adjusted downward to maintain higher prices.

Timing of models' price increases

All model results show that oil prices first shoot up and then drop, in some cases below the pre-disruption price.[5] As expected, spot prices in all the disruption scenarios peaked higher and sooner than contract prices. Figure 3 charts the paths of spot and contract prices in the 10 MMBD disruption case (with maximum SPR drawdown) and shows spot prices' earlier and higher peak.

Except for the most severe disruption, prices were shown to keep rising after the disruption is over, due to lags in price response to market changes and continued inventory buildup. Spot prices generally peak between the last quarter of the disruption year (1983) and the end of the first half of the following year (1984). Following spot prices, contract prices generally peak in the latter half of 1984, the year after the disruption.

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[5] The model results show that in some cases prices drop below the original level. However, in past supply disruptions, prices have not returned to their original level in part because lost production was never fully restored. The models do not capture this effect because production is fully restored at the disruption's end. If intentional production cuts were maintained, the models would show a permanent price increase.

A major problem associated with disruptions is the swiftness of the price increase. The economy and consumers have little time to adjust to rapid increases. The size of the disruption determines how swiftly prices will rise, with the larger disruptions accelerating the rise in both spot and contract prices. Prices peak earlier in the larger disruptions. For example, spot prices peak in the fourth quarter of 1983 in the 19 MMBD disruption and in the first half of 1984 in the 3 MMBD disruption.

FACTORS DETERMINING THE SEVERITY OF THE INCREASE

Disruption size

The size of the disruption in terms of production or capacity loss is the most important factor determining how high prices go. As shown in Figures 4 and 5, spot and contract prices increase exponentially with disruption size. Price increases for all figures presented are nominal, meaning that they include increases in inflation. Unless otherwise specified, model results from current slack market conditions are presented.[6] Our 3 MMBD disruption shows modest increases over the base. Current slack market conditions imply that prices should fall due to a surplus of oil relative to demand. However, models show large to severe price shocks more than drying up the current surplus, in the 10 MMBD and 19 MMBD disruptions. The larger the disruption, the sharper the consumption and contract price drop one to two years after the disruption's end.

3 MMBD disruption

Even with slack market conditions, the 3 MMBD disruption generally results in modest price increases since the supply disruption tightens the market. In Hubbard's model, contract prices fell slightly but would have fallen even more if the disruption had not occurred. In GAO's model, the 3 MMBD disruption temporarily raised official crude oil prices by up to about $6/barrel (from a base price of about $31 per barrel) at the peak. As shown in Figure 4, spot prices may rise by more then $7/barrel. According to the GAO model, which examines price effects through 1987, spot prices return to their original level in mid-1986. Contract prices return to "normal" in 1987, almost 4 years after the disruption's end.

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[6] Slack market conditions are defined as mid-summer 1982 market conditions, when OPEC was producing at 65 percent of capacity.

FIGURE 3

SPOT AND CONTRACT PRICES IN A 10MMBD
DISRUPTION
(GAO MODEL)

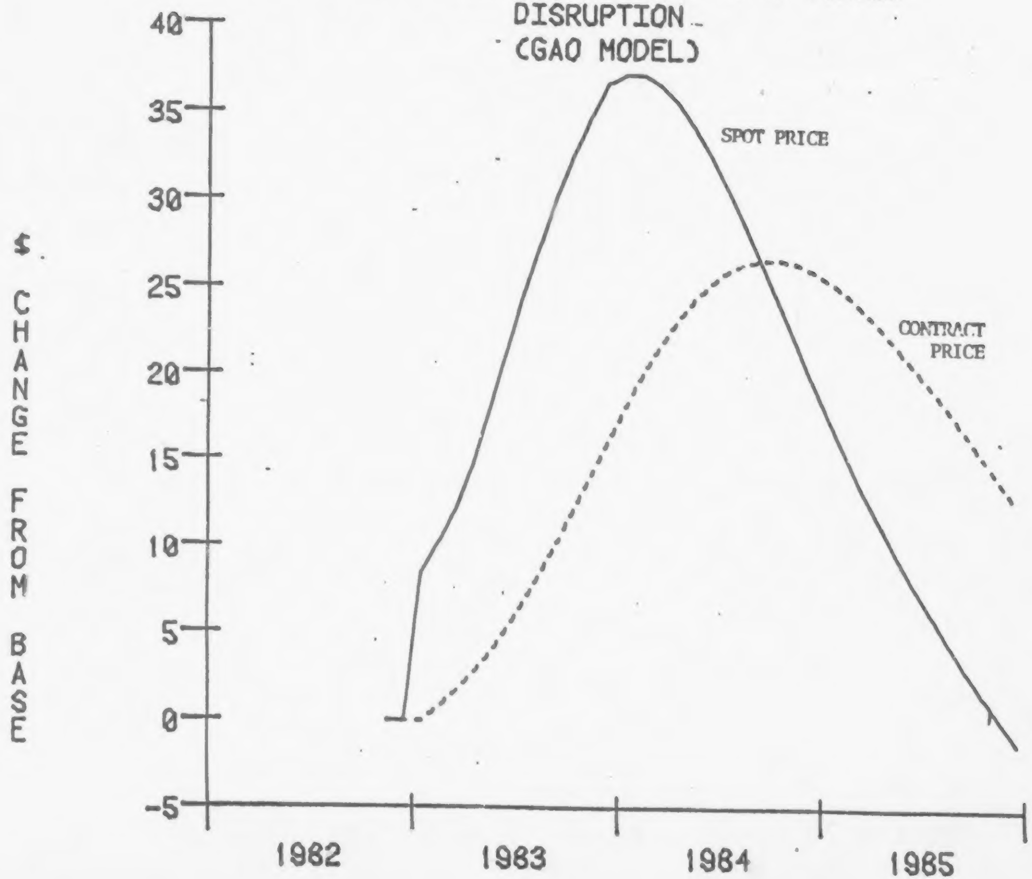


FIGURE 4

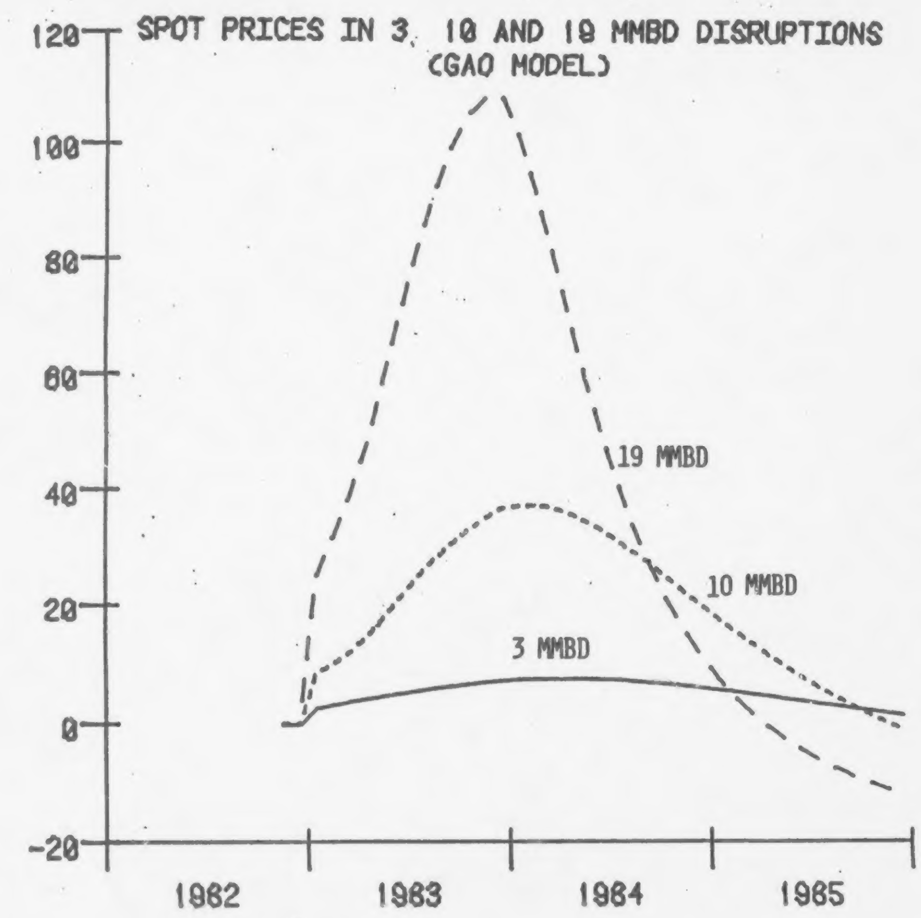
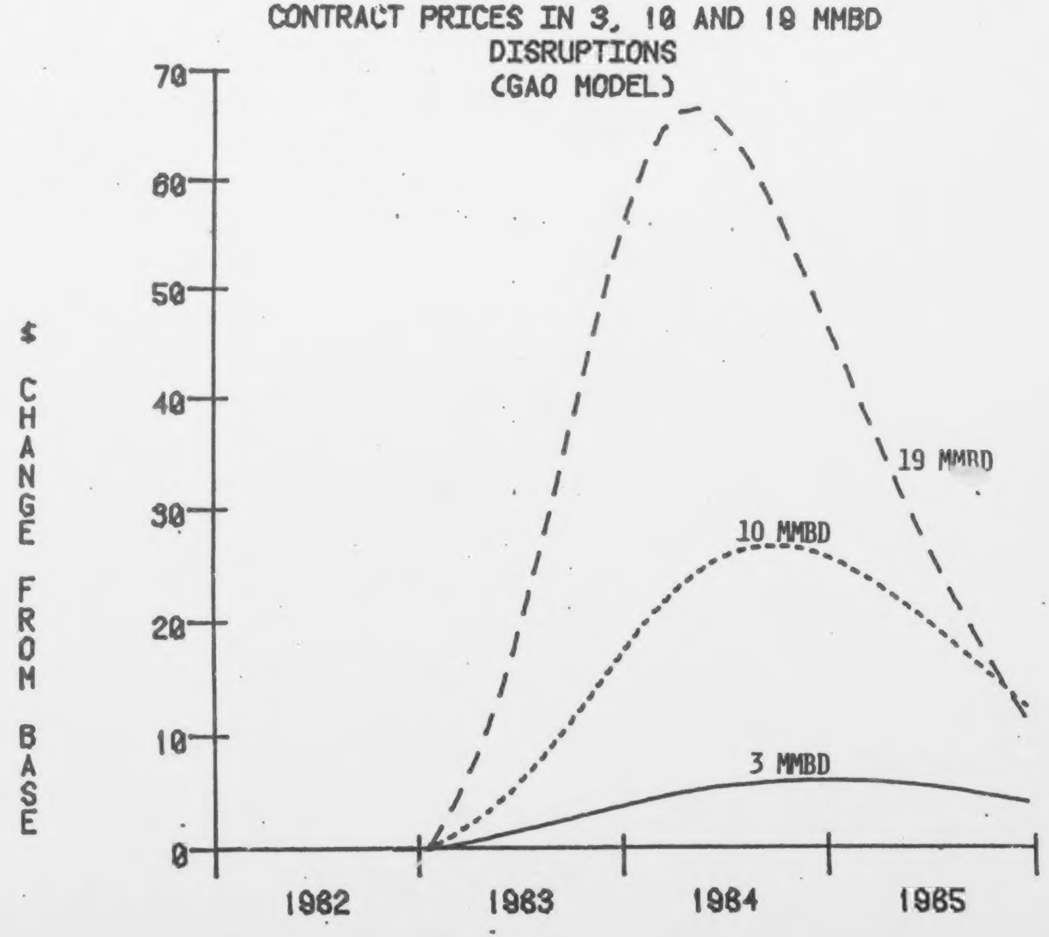

SPOT PRICES IN 3, 10 AND 19 MMBD DISRUPTIONS
(GAO MODEL)
$ CHANGE FROM BASE
120
100
80
60
40
20
0
-20
1982
1983
1984
1985
19 MMBD
10 MMBD
3 MMBD

FIGURE 5



CONTRACT PRICES IN 3, 10 AND 19 MMBD
DISRUPTIONS
(GAO MODEL)

10 MMBD disruption

Despite slack market conditions and assumed maximum SPR drawdown, the 10 MMBD disruption results in large price increases. As shown in Figure 4, spot prices rise by as much as $37 per barrel. This more than doubling of spot prices is accompanied by a doubling of contract prices at their peak, which, as Figure 5 shows, rise by $27 per barrel.

Figure 4 shows that spot prices drop below their starting point at the end of 1985. Although it does not appear on this chart, contract prices would be expected to do the same in early 1987. As a result of reduced consumption accompanying the price shock, the GAO model's spot prices continued to drop until early 1987.

19 MMBD disruption

Model authors do not place much confidence in their models' ability to measure the effects of such a large disruption because basic oil market relationships may break down. (See Chapter IV, p. 38 for an explanation.) However uncertain, the effects of a disruption this large would likely be severe. Despite their unreliability, we show these results to make this point.

Even with market slackness and maximum SPR drawdown, spot prices could rise by about 350 to 470 percent at their peak, depending on the model. In the GAO model, spot prices would temporarily rise by over $100 per barrel. Contract prices could rise by between $66 and $76 per barrel (depending on the model), an increase of over 200 percent. This would bring the official price of crude oil in both models to about $100 per barrel in mid-1984. Figures 4 and 5 show how price effects in the 19 MMBD case are exponentially larger than in the other cases.

Price increases are partially moderated as oil demand falls. The original price shock causes a large oil consumption drop as prices rise and the economy goes into recession. Both Hubbard's and GAO's models produce oil consumption reductions as high as one-third. This large reduction also explains why prices drop quickly after they peak, declining even below their original levels.

Market tightness

The degree of market tightness, defined as the percent of available production capacity in use, plays a major role in determining the size of price increases in a disruption. We therefore modelled both a "slack" and a "tight" market scenario, the former reflecting a plausible greater degree of market tightness. The "slack" market was defined as production at 65 percent of capacity, while the "tight" market was production at the disruption's outset of about 75 percent of capacity.[7] Figure 6 shows GAO's spot prices for both current and tight markets in the 10 MMBD disruption scenario. At its peak, increased market tightness raises spot prices by about $16 per barrel or an additional 50 percent. Figure 6 shows that as spot prices recede, tight market prices drop below slack market prices. This price drop is caused by the tight market cases' higher stock drawdown and demand reduction in 1985.

The price effects of varying degrees of tightness grow with the disruption size. The larger the disruption, the greater the price difference that market tightness makes. This effect can be clearly seen in Figures 1 and 2 (see pp. 11-12), which shows the GAO model's additions to spot and contract prices at the peak in both slack and tight markets. In the 3, 10, and 19 MMBD disruptions, the GAO model's market tightness increases spot prices by up to 13, 53, and 153 percent respectively. The models produce steep spot price growth when both disruption size and market tightness are increased, because spot prices are exponentially related to the production-to-capacity ratios. Raising both disruption size and market tightness increases this ratio, thereby causing a disproportionately large price shock.

Oil inventory behavior

Oil inventory (stock) behavior can greatly influence prices in a disruption. Private stock buildup can intensify the price shock, whereas SPR or private stock drawdown can help moderate the increase. Private stock accumulation in our disruptions ranged from about 300 MBD to 5 MMBD at its peak, depending on the disruption size. While the SPR held 278 million barrels (as of September 1982), the maximum drawdown rate is currently 1.7 MMBD.

Private stocks

Private stocks in past disruptions--Past research and an examination of past disruptions reveal that private oil stock accumulation is a key factor in the upward price spiral accompanying disruptions. Evidence of such inventory accumulation is abundant. For instance, in his recent book, Verleger states that oil companies acquire stocks during shortages, thereby raising

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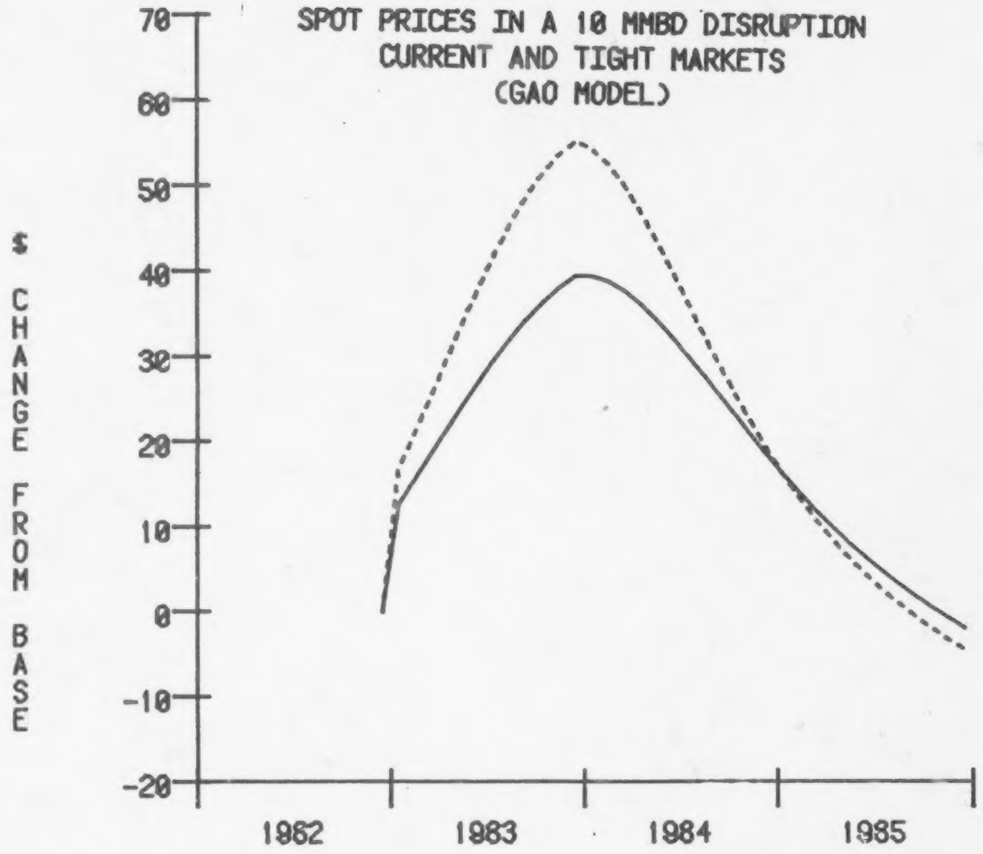
[7] See chapter I, p. 7 for a detailed explanation of our market tightness assumptions.

FIGURE 6



SPOT PRICES IN A 10 MMBD DISRUPTION
CURRENT AND TIGHT MARKETS
(GAO MODEL)

spot prices and increasing the shortage. He estimates that during the Arab oil embargo, refiners accumulated stocks at a rate of over 800 MBD.[8]

Stock buildup also occurred during the Iranian oil cutoff. Although seasonally adjusted International Energy Agency countries' stocks fell about 5 percent in terms of consumption days at the outset of the disruption, they rose about 4 percent during the first quarter of 1979, before exports resumed in March 1979. This first quarter stock rise occurred despite higher oil demand. Danielson claims that "The so-called supply crisis of 1979 was in reality an inventory problem, as indicated by the fact that production exceeded consumption by about 0.8 million barrels per day and inventories increased by 300 million barrels."[9]

Inventory accumulation during a disruption is caused by an expectation of rising prices and uncertainty over whether the disruption may worsen. Verleger determined that oil companies build stocks when spot prices are expected to rise, as indicated by a growing divergence between spot and official oil prices. He stated that individual oil companies are acting in a rational economic manner because buying oil today can be profitable when the price is expected to be higher tomorrow. Hubbard's and Weiner's research indicates that oil companies are apt to stock up when (1) prices are expected to increase by more than the cost of holding stocks, (2) stocks are low relative to sales, and (3) consumption is unexpectedly low.[10]

Oil consumers also build inventories during disruptions, for instance, by topping gasoline tanks and filling storage tanks. Expectations of shortages and rising prices cause consumers and distributors to "panic buy" or stock up on supplies.

Model results--Figure 7 shows the GAO model's expected inventory accumulation for the 3, 10, and 19 MMBD disruption cases. The volume of stocks accumulated accelerates steeply with the disruption size. Stock buildup for the 3, 10, and 19 MMBD

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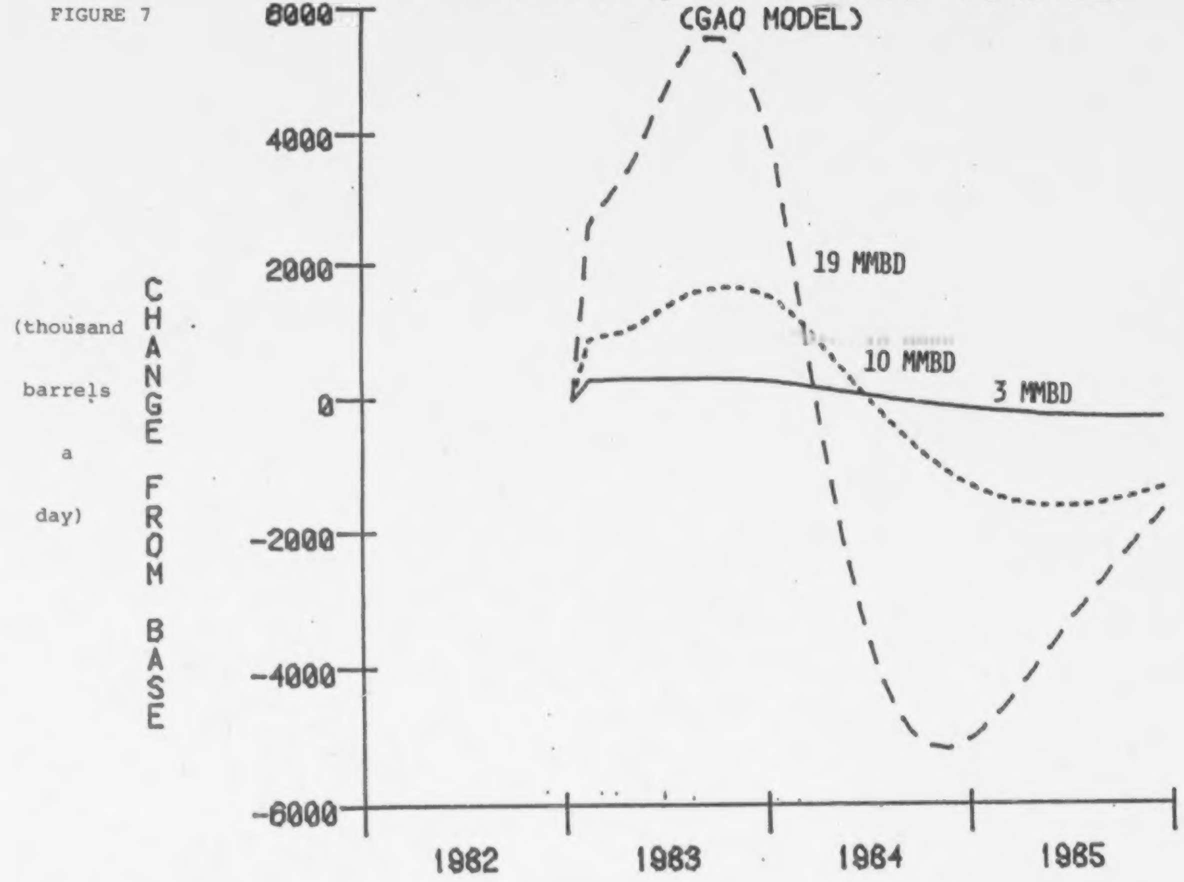
[8] Verleger, Philip K., Oil Markets in Turmoil, Ballinger Publishing Company, Cambridge, Mass., 1982, p. 93.

[9] Danielson, Albert L. and Selby, Edward, B., "World Oil Price Increases: Sources and Solutions." The Energy Journal, October 1980, p. 60.

[10] Hubbard, R. Glenn and Weiner, Robert, The "Sub-Trigger" Crisis: An Economic Analysis of Flexible Stock Policies Harvard University, Cambridge, Mass., 1982, p. 14.

FIGURE 7

INVENTORIES IN 3, 10 AND 19 MMBD DISRUPTIONS (GAO MODEL)



cases peaked in 1983 at 0.3 MMBD, 1.6 MMBD and 5.3 MMBD respectively. Figure 7 also shows the stock drawdown and subsequent replenishment that occurs after the disruption ends. As also shown in Figure 7, the larger the buildup, the larger the eventual stock release.

During our study, Mork tested the effect of stock buildup on oil prices during disruptions. This test was possible because, unlike the other models, Mork's uses stocks estimates determined outside the model. Mork's model was run with and without Hubbard's stock changes. However, since Mork's model is annual, and stock changes are smoothed over the year, price peaks are likely to be understated. In the 3 MMBD case, Mork's results showed that a small stock buildup (averaging about 78 MBD over 1983) made only a 30 cent per barrel difference. The price difference in 1983 was substantial in the larger disruptions, nearing $8 per barrel in the 10 MMBD disruption.

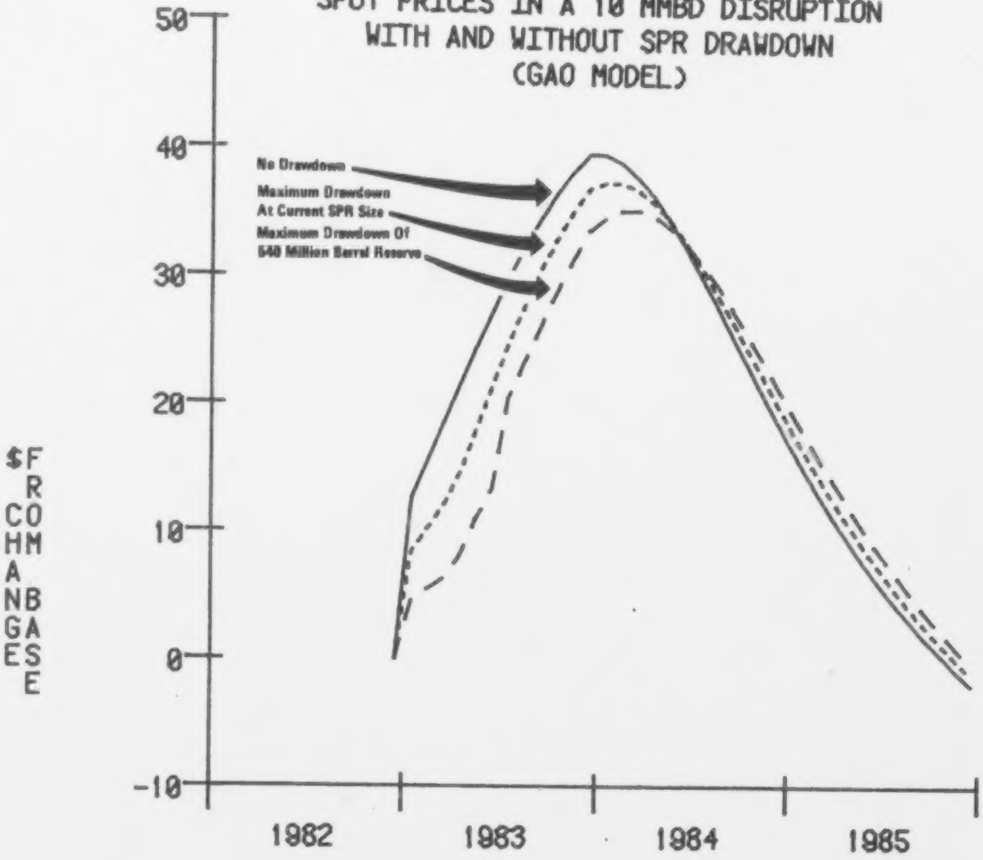
SPR drawdown

The SPR, the U.S. government's oil inventory, has the potential to reduce the price increase in a disruption. We examined the price effects of maximum versus no drawdown in a 10 MMBD disruption and found that, over 1983, drawdown made a $5 or 8 percent difference in the GAO model's spot price results and a slightly lower 6 percent difference in the prices predicted by Hubbard's model. Maximum SPR drawdown lowered spot prices by only about $2 per barrel at the spot price peak. This lower peak price difference occurs because prices peak during 1984, while SPR drawdown occurred in the first three quarters of 1983. Figure 8 shows that SPR drawdown lowers both the price increase and the price falloff associated with supply disruptions.

Models may underestimate the price effects of SPR drawdown because they do not take into account that SPR oil could have a disproportionately large influence on spot prices. According to the Department of Energy's Strategic Petroleum Reserve Drawdown Plan, most SPR oil drawn down during disruptions will be sold by auction. Because the oil will be auctioned during the disruption, as opposed to sold in advance under long-term contract, it is by definition being sold on the spot market. The 1.7 MMBD drawdown rate is comparable to the amount of oil usually sold on the spot market so spot price effects may be substantial. However, the SPR's current size and maximum drawdown capabilities limit the leverage it can have over prices in large disruptions. Maximum drawdown for the first 3 months of a disruption is 1.7 MMBD and the amount tapers off quickly thereafter. At 1.7 MMBD, the SPR represents only about 3 percent of current world oil production. The drawdown amount may also be small relative to disruption size.

FIGURE 8

SPOT PRICES IN A 10 MMBD DISRUPTION
WITH AND WITHOUT SPR DRAWDOWN
(GAO MODEL)



Despite limited drawdown capability, the SPR can affect prices somewhat. Furthermore, as the SPR grows and develops a larger drawdown capability, it will allow greater flexibility in drawdown and can be a more useful counter to price increases. This can also be observed in Figure 8, where the price effects of drawdown when the SPR reaches a level of 540 million barrels are shown. The Department of Energy plans on completing Phase II, where this fill level will be achieved, by the end of fiscal year 1986. Maximum drawdown capability of a Reserve of this size is more than twice as large as the current rate, ranging from averages of 3.5 MMBD in the fist 3 months to 1.9 MMBD in the sixth and last month of drawdown. Averaged over 1983, maximum drawdown at these rates lowered the spot price increase by 17 percent.

CONSUMER OIL PRICES

Consumer oil prices in past disruptions

Consumer prices respond sluggishly to supply disruptions because they follow contract rather than spot prices. In addition, short-term demand is not very responsive to price changes. A larger demand reduction would lower the disruption-induced price increase.

In his recently published book, Verleger concludes that "oil companies tend to raise consumer prices too slowly during disruptions," because they follow OPEC (e.g., contract) rather than the spot market in setting prices, and because of actual or anticipated government restrictions.[11] This observation is supported by examining the behavior of spot, contract, and heating oil price increases resulting from the 1979 Iranian oil disruption. Between October 1978, at the outset of the disruption, and October 1979, heating oil and contract oil prices increased at an average rate of about 4 percent per month, while spot prices rose at a rate of 9 percent per month.

In addition to the delay in demand response, short-term demand is not very responsive (inelastic) to changes in price. In the short-run, oil consumer ability to substitute other fuels and alter energy use patterns is limited. This lack of short-run demand response to a disruption makes both spot and contract prices rise more than they would have if there had been a greater demand reduction.

In the long-run, the rise in consumer oil prices changes consumption patterns and spot prices stabilize or drop. Following spot prices with a lag, consumer prices drop. Large price shocks can cause precipitous demand reductions one to two years after the disruption's end. This process was evident after the 1979 Iranian oil cutoff. In the two years following the cutoff, yearly average International Energy Agency countries' petroleum consumption fell by about 13 percent. This drop primarily results from reduced economic growth, fuel efficiency improvements, conservation measures, and fuel switching, which were brought about by the sharp rise in oil prices. For example, gasoline prices peaked in March 1981, two years after the disruption's end, and fell by 9 percent through the first quarter of 1982.

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[11] Verleger, Philip K., Oil Markets in Turmoil, Ballinger Publishing Company, Cambridge, Mass., 1982, p. xxvi.

Model results

Our model results show that consumer oil prices follow contract oil prices with a two month lag, and generally peak between the second and fourth quarters of 1984. Table 1 shows gasoline price increases in the four disruption cases. Heating oil price increases are generally the same as those for gasoline. Residual fuel price increases are somewhat lower dollar amounts.

Table 1
Additions to Gasoline Prices
Caused by Oil Supply Disruptions [a]
(GAO Model)

	1983	1984	1985	Quarter Peak
	- - - - (dollars	per	gallon) - - - -	
3 MMBD	$ .11	.23	.22	.25
Slack market 10 MMBD	.39	.93	.64	.97
Tight market 10 MMBD	.52	1.22	.74	1.28
19 MMBD [b]	.92	2.00	.84	2.20

[a] Results are for current market conditions and do not include SPR drawdown unless otherwise noted. The assumed base gasoline price is $1.29 per gallon.

[b] Includes SPR drawdown at maximum rate.

As shown in Table 1, gasoline prices could rise by as much as 25 cents per gallon, or 19 percent in a 3 MMBD disruption. In a 10 MMBD disruption, gasoline prices may temporarily rise by $.97 to $1.28 or as much as 75 to 100 percent, depending on the extent of market tightness at the disruption's outset. Table 1 also shows that, in a 19 MMBD disruption, gasoline prices may rise by $2.20 per gallon at their peak. This amount represents a temporary increase of about 170 percent.

Disruptions will also raise the price of residual fuel oil, which is mostly used by industrial boilers and electric utilities. At their peak, price increases range from 16 cents per gallon in the 3 MMBD disruption to $1.42 per gallon in the 19 MMBD disruption.

CHAPTER III

ECONOMIC EFFECTS OF OIL SUPPLY DISRUPTIONS

Oil price shocks accompanying supply disruptions have hurt the U.S. economy and have been a major cause of inflation and recession in the 1970s. Our research shows that the severity of the economic impacts of a disruption, in terms of increased inflation and unemployment and reduced economic growth, depends on the size of the price shock accompanying the disruption. As we expected, the economic effects of a 3 MMBD disruption would be modest, while a Persian Gulf disruption would severely damage the U.S. economy. The adverse economic effects of disruptions are temporary with one exception. They result in a permanent one-time GNP loss, which is mostly due to lost investment.

The literature identifies two ways in which oil price shocks weaken the Nation's economy: direct (or wealth transfer) costs and indirect (or adjustment) costs. The economy bears direct costs when raising the price of imported oil causes a transfer of income from consuming to producing nations. The indirect costs are caused by the rise in the price of oil relative to other production inputs. Oil is an input into the production of other goods and services as well as final goods. Disruptions raise oil costs, reducing profit-maximizing output of oil-using firms and thereby lowering GNP. As GNP shrinks, the demand for labor and non-energy inputs declines. To the extent that real wages and non-energy prices do not fall, demand for labor and materials falls, further increasing unemployment.

The economic results generated by the Mork, Hubbard, and GAO[1] models differ in severity and timing, especially the results of the Mork model. Due to greater concentration of price effects in the disruption year, Mork's model generally produces more severe economic effects in that year and less severe effects thereafter.

The remainder of this chapter focuses on how the price shocks caused by supply disruptions affect inflation, economic growth, and unemployment. Because the models' economic results are not as similar as their oil price results, either ranges of model results or the maximum effects are presented here, depending on which is more appropriate. Oil price shocks can also cause substantial income redistribution, from the United States to foreign producers, and from domestic oil consumers, labor, and owners of capital to oil producers. While these effects are not presented here, they can be broadly estimated by multiplying the oil price increase by oil imports before and after the disruption.

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[1] To obtain economic effects for GAO's oil model, results were used in Data Resources Inc.'s Macroeconomic model.

INFLATION

Supply disruptions can increase inflation by increasing the price of energy and energy-using goods and services. In the short-term, these price increases are probably not offset by a decline in wage rates or the price of non-energy using goods and services.

Table 2, presenting inflation rates in the last decade, reveals a large increase in the inflation rates in 1974 and 1979, the years following world oil supply disruptions. Although other factors may be involved, researchers have cited the oil disruptions as a principal cause of increased inflation in these periods. A study by Data Resources Inc., concluded that the oil price increases from the Arab oil embargo added about 1.8 percentage points to the U.S. inflation rate in 1974 and 1975.[2] The University of Michigan's model has similar results, with the inflation rate increasing by 1.8 percent in 1974, as a result of the embargo.[3] Mork and Hall estimated that the 1979 energy price shock added 1.8 percentage points to the inflation rate in 1979 and 1.3 percent in 1980.[4]

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[2] Data Resources, Inc., "1980 Oil Embargo Study," U.S. Long-term Review, Fall 1977, p. 2.

[3] Mork, Knut and Hall, Robert E., "Energy Prices, Inflation, and Recession, 1974-75," The Energy Journal, July 1980, p. 51.

[4] Mork, Knut and Hall, Robert, "Macroeconomic Analysis of Energy Price Shocks and Offsetting Policies: An Integrated Approach." Edit. by Mork, Knut. Energy Prices, Inflation, and Economic Activity. Ballinger Publishing Company, Cambridge, Mass., 1981, p. 51.

Table 2

Inflation, Economic Growth, and Unemployment in the United States

Year	Inflation (CPI)	Real GNP growth	Unemployment rate
1970	5.9	- .2	4.9
1971	4.3	3.4	5.9
1972	3.3	5.7	5.6
1973	6.2	5.8	4.9
1974	11.0	- 0.6	5.6
1975	9.1	- 1.1	8.5
1976	5.8	5.4	7.7
1977	6.5	5.5	7.1
1978	7.7	4.8	6.1
1979	11.3	3.2	5.8
1980	13.5	- 0.2	7.1
1981	10.4	- 1.9	7.6

Source: Economic Report of the President, Feb. 1982, Table B-55, p. 295, Table B-5, p. 239, Table B-33, p. 271.

Table 3 shows the annual increases in the inflation rate caused by the three disruptions under slack market conditions estimated by the models. In the 3 MMBD disruption, the inflation rate is estimated to grow by one-half of one percent or less in any year. The 10 MMBD disruption causes annual peak increases ranging from 1.9 to 2.6 percent, depending on the model. The Persian Gulf disruption case has severe inflationary effects, with the three model's annual increases extending from 3 to 11.4 percent at their peak.

Mork's results for 1983 exceed those of the other two models because the price shock is concentrated in that year. Inflation increases for the other models peak on an annual basis in 1984. However, the quarter with the highest peak generally is in the first half of 1985. Hubbard's Persian Gulf disruption case results in a surprisingly small addition of three percent to the inflation rate in 1984, partly because the recession caused by the large price shock constrains inflation.

Table 3

Additions to the Inflation Rate Caused by Oil Supply Disruptions [a]

	1983	1984	1985
	----(Percent change in the GNP Implicit Price Deflator)---		
3 MMBD			
Mork	0.3	0	0
Hubbard	0.1	0.4	0.2
GAO	0	0.5	0.3
10 MMBD			
Mork	2.5	-0.1	-0.1
Hubbard	0.5	1.9	0.7
GAO	0.2	2.6	1.9
19 MMBD [b]			
Mork	11.4	-3.2	-1.3
Hubbard	1.0	3.0	1.0
GAO	0.3	6.4	2.4

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[a] Rate of change in the GNP price deflator, except for Mork's 1983 change, where we used the deflator for personal consumption expenditures. Results shown are for current market conditions.

[b] Includes maximum SPR drawdown.

ECONOMIC GROWTH

Oil supply disruptions and their accompanying price shocks reduce the GNP growth rate during the two years following the disruption's outset. Although the growth rate eventually catches up and temporarily exceeds the base rate, a permanent loss in GNP remains.

Much of economic literature considers oil supply disruptions to have greatly contributed to the recessions in 1975 and 1980. Table 2 shows that real GNP growth dropped dramatically in the years following the 1973-74 Arab oil embargo and 1979 Iranian oil disruption. Data Resources Inc. concluded that the 1973-74 oil price shock reduced real GNP by 3 percent in 1974.[5] According to Mork's model, the embargo caused GNP to drop by 2 percent in

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[5] Data Resources, Inc., "1980 Oil Embargo Study," U.S. Long-term Review, Fall 1977, p. 2.

1974 and 5 percent in 1975.[6] The University of Michigan's model attributed a 1.5 percent GNP drop in 1974 and a 4 percent drop in 1975 to the embargo.[7] The Congressional Budget Office believes that the Iranian oil cutoff and Federal Reserve Board reactions caused GNP growth to fall from an annual rate of 1.2 percent in the first quarter of 1980 to minus 9.6 in the second.[8]

The model results show, as expected, that small disruptions have modest effects on economic growth and that larger disruptions could have severe effects. Table 4 indicates that the 3 MMBD disruption would lower GNP growth by no more than 0.4 percent at its peak. This would mean that if GNP would have grown at an annual rate of 3 percent without the disruption, it would grow at a rate of 2.6 percent with the disruption. The 10 MMBD disruption could temporarily reduce real GNP growth by as much as 0.5 to 3.2 percent, depending on the model, which translates into a loss of up to $98.6 billion in 1982 dollars.

As we expected, the annual and sub-annual models diverge widely on the economic growth effects of a 19 MMBD disruption. The sub-annual models focus on the short-term effects of disruptions which we would expect to be larger than the long-term effects. Table 4 shows that the annual peak loss ranges from 1.5 to 13.3 percent, depending on the model. Despite different results, the 19 MMBD disruption has severe impacts in all cases. The peak average annual GNP loss in terms of 1982 dollars ranges from about $71 billion to $415 billion, depending on the model. Furthermore, the economic growth reductions in certain quarters are much larger than the annual averages indicate. Although Hubbard has a comparatively small 1.5 percent average loss for 1983, the loss during the peak quarter at an annual rate is 3.2 percent.

The timing of economic losses is evident in the sub-annual models. Economic losses generally peak during the last quarter of the disruption year. However, in the GAO model's 19 MMBD case, losses peak in the third quarter. Mork's model shows large GNP growth in the year following the disruption because investments that were postponed throughout the disruption year are made at this time.

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[6] Mork, Knut and Hall, Robert E., "Energy Prices, Inflation, and Recession, 1974-1975," The Energy Journal, July 1980, p. 51.

[7] Ibid., p. 51.

[8] U.S. Congressional Budget Office, Managing Oil Disruptions: Issues and Policy Options, U.S. GPO, Washington, D.C., 1981, p.3.

Although the economic growth rate "catches up" with the non-disruption growth rate by the end of 1985, a loss in GNP remains. For example, in Mork's 10 MMBD disruption case, a GNP loss of 1.5 percent exists even in the year 2014. This permanent, one-time GNP loss is primarily caused by reduced investment,

Table 4

Changes in the Real GNP Growth Rate Caused by Oil Supply Disruptions a/

	1983	1984	1985
	(percent)		
3 MMBD			
Mork	- 0.4	+ 0.1	+ 0.1
Hubbard	- 0.2	- 0.2	+ 0.1
GAO	- 0.1	- 0.1	+ 0.3
10 MMBD			
Mork	- 3.2	+ 1.9	+ 0.5
Hubbard	- 0.5	- 0.5	+ 0.5
GAO	- 1.1	- 1.1	+ 0.7
19 MMBD b/			
Mork	-13.3	+10.8	+ 0.9
Hubbard	- 1.5	- 0.7	+ 0.1
GAO	- 2.7	- 2.5	+ 2.3

a/Reductions in GNP growth have negative signs.

b/Includes maximum SPR drawdown.

with non-energy investments being reduced by 21 percent in the disruption year. Pindyck and Rotemberg point out that price shocks reduce investment because they increase inflation and interest rates and they increase uncertainty about the profitability of private investment.[9]

UNEMPLOYMENT

Price shocks caused by oil supply disruptions increase unemployment, although the increase is delayed and severe only in the larger disruptions. Price shocks reduce consumer demand for products[10] and thus output, thereby lowering the demand for labor. In the face of this lower demand for labor, maintenance of full employment would require a real wage decline. However, since wages fall slowly, if at all, wage rigidity results in increased unemployment.

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[9] Pindyck, Robert S. and Rotemberg, Julio J., Energy Shocks and the Macroeconomy, Massachusetts Institute of Technology, Cambridge, Mass., 1982, p. 12.

Table 2 shows that unemployment increased sharply for the two years following the 1973-74 Arab oil embargo and the 1979 Iranian oil supply cutoff. Unemployment increased by a total of 3.6 percent from 1973 to 1975, and by 1.8 percent from 1979 to 1981, although these increases are not caused exclusively by higher oil prices. Data Resources Inc., concluded that by 1975, the Arab oil embargo had increased the unemployment rate by 1.7 percentage points.[11] Mork and Hall determined that the 1979 price shock increased the unemployment rate by 0.4 percent and 1.2 percent in 1980.[12]

The model results showed that average annual increases in unemployment due to oil price shocks are likely to exceed one percent only in larger disruptions. Table 5 displays the results obtained from the different models. The 3 MMBD disruption, in all models, will increase unemployment by 0.2 percent or less. In the 10 MMBD disruption, additional unemployment peaks at less than 1 percent, except for Mork's 1983 increase. The 19 MMBD disruption is likely to result in increases of greater than 1 percent, and Mork's model suggests an increase of nearly 6 percent.

Unemployment effects follow the economic growth effects and, as shown in Mork's model, last for about two years. The timing of unemployment is more evident in the sub-annual models. For example, in the 10 MMBD disruption, unemployment usually starts rising in the middle of 1983 (the disruption year), and peaks in either the end of 1984 or the first half of 1985. In general, these models show that the larger the disruption, the sooner the impact on unemployment. The delay in unemployment effects occurs because unemployment increases in response to the initial decline in output. In Mork's model, unemployment decreases in 1985 because labor is replacing the largely reduced capital stock.

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[10] In the short-run, consumer demand for products other than oil should not increase sufficiently to offset the decrease in demand for oil products. Thus, overall consumer demand should decrease.

[11] Data Resoures Inc., "1980 Oil Embargo Study," U.S. Long-term Review, Fall 1977, p. 2.

[12] Mork, Knut and Hall, Robert, "Macroeconomic Analysis of Energy Price Shocks and Offsetting Policies: An Integrated Approach." Edit. by Mork, Knut. Energy Prices, Inflation, and Economic Activity. Ballinger Publishing Company, Cambridge, Mass., 1981) p. 51.

Comparing these unemployment effects to those in the current recession puts their severity in perspective. From its beginning to the current trough,[13] unemployment has grown by 2.6 percent. As shown in Table 5, the Persian Gulf disruption is the only case where unemployment effects exceed those in the current recession.

Table 5

Additions to Unemployment Rates Caused by Oil Supply Disruptions

	1983	1984	1985
	- - - - (p e	r c e n t)	- - -
3 MMBD			
Mork	0.2	0.1	0
Hubbard	0	0.1	0.1
GAO	0	0	0.1
10 MMBD			
Mork	1.4	0.2	-0.1
Hubbard	0.2	0.4	0.2
GAO	0.2	0.5	0.7
19 MMBD [a]			
Mork	5.7	-0.3	-0.5
Hubbard	0.6	0.9	0.9
GAO	0.4	1.4	1.6

[a] Includes maximum SPR drawdown.

In addition, small increases in the unemployment rate translate into a substantial loss of jobs. A one percentage point increase in the unemployment rate, represents a loss of over one million jobs. In the 3 MMBD disruption, for example, Mork's 1983 unemployment increase of 0.2 percent means 224,000 fewer jobs. In the 10 MMBD disruption, unemployment increases, at their peak, represent losses ranging from about 450,000 to 1.6 million jobs, depending on the model. All models show that peak losses in the Persian Gulf disruption would exceed one million, while Mork's 1983 unemployment increase of 5.7 percent reflects the loss of 6.4 million jobs.

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[13] As of the third quarter of 1982.

CHAPTER IV

CONCLUSIONS, POLICY IMPLICATIONS, AND KEY AREAS WHERE ADDITIONAL RESEARCH IS NEEDED

CONCLUSIONS

Oil Price effects

--Despite current slack market conditions and assuming SPR drawdown at the maximum pumping rate, oil price increases in large supply disruptions could be severe.

--Except for the most severe disruptions, oil prices keep rising after the disruption is over due to lags in the price response to market changes and continued inventory buildup. Spot prices generally peak between the end of the disruption year and the first half of the following year. Following spot prices, contract prices generally peak in the latter half of the year after the disruption.

--Disruption size, market tightness, and oil stockpiling behavior are important factors determining the severity of oil price increases in disruptions.

Disruption size

--The price increase grows exponentially with the size of the disruption. Prices also peak earlier in the larger disruptions. Under slack market conditions, 3 MMBD, 10 MMBD, and 19 MMBD disruptions would raise contract crude oil prices by about $6, $27, and $66 per barrel, respectively, at their peaks.

--In large disruptions, price increases are moderated by a recession-induced oil consumption drop.

Market tightness

--Disruptions in tighter oil markets would result in greater price increases, and the larger the disruption, the greater the price difference that increased market tightness makes.

Oil stock behavior

--Private oil stock buildup, caused by expectations of rising oil prices and uncertainty over whether the disruption may worsen, adds to the shortage, and thus further increases oil prices.

--SPR drawdown can reduce the size of the price increase somewhat but its current size and maximum drawdown capability of 1.7 MMBD limits its leverage on world oil prices. When the Reserve reaches 540 million barrels, the drawdown rate will double, as will the Reserve's impacts on oil prices.

Consumer oil prices

--Consumer oil prices respond sluggishly to disruptions because they follow contract rather than spot prices.

--Under slack market conditions, gasoline prices in 3, 10, and 19 MMBD disruptions could temporarily rise by as much as $ .25, $ .97, an $2.20 per gallon, respectively, at their peaks.

Macroeconomic effects

--Oil price increases hurt the U.S. economy by causing a transfer of income from consuming to producing nations and by raising the price of oil relative to other production inputs.

Inflation

--Inflation, caused by increases in energy costs and the costs of energy-using goods and services, increases by one-half a percentage point or less in the 3 MMBD disruption. Larger disruptions can cause severe inflation, with the Persian Gulf disruption increasing inflation by about 3 to 11 percent (depending on the model) at the peak.

Economic Growth

--Oil price shocks reduce the GNP growth rate during the two years following the disruption's outset. Although the growth rate eventually catches up, a permanent loss in GNP remains, primarily due to lost investment.

--The models show that small disruptions have modest effects on economic growth with the 3 MMBD disruption reducing the economic growth rate by no more than 0.4 percentage points at its peak. The 10 MMBD disruption could temporarily reduce real GNP growth by up to 3 percentage points, while the 19 MMBD disruption could reduce GNP growth by up to about 13 percent.

Unemployment

--Oil price shocks increase unemployment by reducing consumer demand for products and output, thereby lowering the demand for labor. Unemployment increases are delayed and greater than one percent only in the larger disruptions. In the Persian Gulf disruption, peak increases in the unemployment rate range from about 1 to 6 percent, depending on the model.

--Even small percentage increases in the unemployment rate represent a substantial loss of jobs. In the 3 MMBD disruption, for example, a 1983 unemployment increase of 0.2 percent means 224,000 fewer jobs, while a 19 MMBD disruption's 5.7 percent increase reflects the loss of 6.4 million jobs.

POLICY IMPLICATIONS

We found that disruption size, market tightness and oil stocking behaviors are three important factors determining the size of the oil price shock in a disruption. While little can be done about the disruption size, our findings indicate that maintaining a slack oil market and adequate private stocks before a disruption, and drawing down private stocks and the SPR during a disruption will help to moderate the price increase.

Maintaining a slack oil market

Our research shows that the degree of market tightness plays a major role in determining the size of the price increase in a disruption. For example, in GAO's 10 MMBD disruption, tightening the market increased spot prices by an additional 50 percent.

The Government could help maintain market slackness by encouraging oil production and exploration in non-OPEC countries; helping to resolve conflicts between oil-producing nations such as Iran and Iraq; developing and/or encouraging the use of alternative fuels; and by promoting energy conservation.

Maintaining high oil stocks

Our examination of past disruptions showed that private oil-stocks are built up during disruptions, increasing the size of the shortage and oil prices. Oil stockpiling may be partially motivated by oil companies' fears of not being able to meet their contractual obligations. Holding emergency stocks would reduce company's concerns about inadequate supplies, thereby reducing their motivation to stock up during a disruption.

Maintaining high stocks could significantly reduce the price increase in a disruption by reducing stock buildup. We were unable to model the price effects of varying initial stock levels because the models we used do not accept stock levels as an input. However, isolating its effects from other factors, Verleger's research showed that the stock level at the start of a disruption makes a large difference in the spot price increase. With initial stocks 2.5 percent above "normal," spot values are $15 per barrel lower--nearly 30 percent. Conversely, with initial stocks 2.5 percent below "normal," spot prices are 50 percent higher.

There are a variety of ways the Government could encourage industry to hold oil stocks for emergency use, with varying levels of cost to private industry and the Government. The Government could require oil companies to set aside emergency stocks directly or by creating a separate government corporation. The Government could also provide a variety of financial incentives to companies for holding stocks. We are currently assessing the costs and benefits of government options for encouraging private oil stockpiling and expect to report on this soon.

Encouraging private stock drawdown during disruptions

Maintaining high emergency oil stocks would reduce stock buildup during disruptions; encouraging stock drawdown during disruptions could go further to reduce the price increases. Encouraging private stock drawdown in disruptions could also be accomplished through tax and financial incentives. Since oil stockpiling is partly motivated by an expectation of rising prices, Verleger proposed that a declining disruption tariff be instituted which would discourage stocking up by causing prices to decline.[1]

While some research has been done in this area, we feel that more is needed because knowledge of stock behavior during disruptions is insufficient and research focuses mostly on incentives to maintain stocks before disruptions rather than draw them down during disruptions.

SPR drawdown

As with private stock drawdown, SPR drawdown was found to reduce price increases in disruptions. In a 10 MMBD disruption, maximum drawdown decreased spot prices by 6-8 percent over the disruption year. These price effects of SPR drawdown could be understated. In calculating price increases, the models implicitly assume that SPR oil is sold in the same manner as other oil with spot market sales comprising about 5 percent. In fact, SPR oil would be auctioned during the disruption and might have a disproportionately large influence in reducing spot price increases. Thus, the models may understate the SPR's price mitigation potential. However, the price mitigation potential of the SPR is limited by its current size and maximum drawdown rate. At the SPR's current size, maximum drawdown for the first 3 months is 1.7 MMBD and the amount tapers off quickly thereafter to 0 in the fourth quarter of the disruption year. However, as the SPR grows, it will develop a larger drawdown capability and will be more useful in mitigating price increases.

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[1] Verleger, Philip K., Oil Markets in Turmoil, Ballinger Publishing Company, Cambridge, Mass., 1982, p. xxviii.

KEY AREAS WHERE ADDITIONAL RESEARCH IS NEEDED

In requesting this report, Chairman Sharp asked us to identify any key questions concerning the oil price and economic effects of shortages that have not been adequately assessed. The two sub-annual models we used substantially agree on the timing and severity of price increases. It may be that our overall understanding of oil market behavior has progressed to the point that the underlying common view overwhelms surface differences. We have identified several areas where additional research is needed:

--the effects of large disruptions such as a loss of the entire Persian Gulf,

--the effects of and ways to reduce private stock buildup during disruptions, and

--the effects of different government policies to minimize the economic costs of disruptions.

Oil price and economic effects of large disruptions

More research is needed on the price and economic effects of large oil supply disruptions. Model authors were not confident about the validity of Persian Gulf disruption results and they did not agree on the magnitude of effects. Lack of knowledge in this area is a serious concern because the oil price and economic effects may be severe. Mork's model, for example, showed that a Persian Gulf disruption could temporarily raise the inflation rate by up to 11.4 percentage points, and the unemployment rate by up to about 6 percent.

Model authors do not place much confidence in their models' abilities to measure the effects of so large a disruption. In a disruption this severe, the usual oil market relationships may break down, so models constructed on data reflecting these relationships may no longer be suitable. For example, in large disruptions, limited storage capacity constrains stock buildup, making our models' projected stock buildup unrealistic. Besides physical limitations in the distribution system, shortages could also cause other market relationships to break down. For example, oil purchase contracts could be shortened dramatically, as they were in the 1979 disruption, altering the historic relationship between spot and contract prices. In this case, the models would no longer be suitable for measuring the disruption's price effects. Traditional market relationships may also break down because it is unlikely that governments of industrialized nations would take no countervailing actions in such a severe disruption.

In addition to questions about the models' appropriateness for studying the effects of severe disruptions, model results for the 19 MMBD disruption lack agreement on the magnitude of oil price and economic effects. For example, in the disruption year, inflation is estimated to increase by a range of 0.3 to 11.4 percent (see p. 33). Much of this difference is due to Mork's concentration of the price growth in 1983, versus the other model's prices peaking in the following year. However, even when compared at their peaks, the range in additional inflation is still large (3 to 11.4 percent).

Reducing Private stock buildup during disruptions

Research on past disruptions shows that some of the oil price increase and associated economic costs resulted from oil companies building rather than drawing down oil stocks. Research on the price effects of private stock buildup during disruptions and ways to reduce buildup might help minimize the economic costs of future disruptions. Additional research is needed because knowledge of stock behavior during disruptions is limited and existing research focuses on maintaing emergency stocks rather than encouraging drawdown during a disruption.

The models showed that private stocks are accumulated during disruptions adding to the size of the shortage and prices (see Chapter II, pp. 21 and 23). Additional research on the price effects of inventory behavior are needed. Current knowledge is insufficient to support firm conclusions about how to influence inventories because models showed significantly different stock behaviors and results we did obtain were probably understated. While both the Hubbard and GAO models show substantial stock buildup during disruptions, they produce different patterns of stock behavior. Hubbard's stock behavior is more complex than

GAO's because his stock equation contains two other factors besides expected price increases (see Chapter II. p. 21). In Hubbard's model, stocks can both rise and fall in disruptions, and the initial drawdown more closely resembles past disruptions than does GAO's pattern.

Stock-related price results we obtained may also be understated. Mork's model is the only one where we could readily measure price effects with and without stock changes. However, his model is annual so that stock changes are smoothed over the year, and his model does not include an inventory accumulation spot price spiral like the others. Thus, the price effects of stock buildup are probably understated.

Additional research on ways to discourage stock buildup and encourage drawdown during disruptions would also be useful. While there is disagreement about stock behaviors and their effect on prices in a disruption, researchers agree that stock buildup raises prices substantially. In Oil Markets in Turmoil, Verleger concluded that "the behavior of spot values during a disruption becomes much less volatile when the inventory acquisition practices are stopped or reversed."[2]

Charles River Associates has done research on measuring the size of private oil inventories and on government incentives for encouraging a buildup of private stocks above usual levels for use during emergencies. Their September 1981 study concluded that while price controls provide a disincentive to private stockpiling, capital gains treatment of stockpile profits and investment tax credits are the most promising government incentives for it.[3] However, their studies do not explicitly address incentives to draw them down during disruptions. Besides some work by Verleger and the Harvard Energy Security Program, we are not aware of any research on incentives to discourage buildup during a disruption.

Assessment of government policies to reduce economic costs of disruptions

Determining the consensus, if any, on which government policies are most effective in minimizing the economic costs of oil supply disruptions, would improve the U.S. government's response to future disruptions. Some research indicates that past government policies may have increased the economic costs of disruptions. For example, one of the secondary effects of the Federal Reserve Board's contraction of the money supply after the 1979 Iranian oil disruption was increased interest rates, which further reduced economic growth. Hubbard and Fry's research shows that oil price controls reduce GNP growth more than relying on unregulated markets.[4] This phenomenon occurs because the artificially low price resulting from price controls stimulates U.S. oil demand and increases imports, thereby putting an upward pressure on market prices. The greater eventual price increase under price controls results in a higher reduction in GNP growth.

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[2] Verleger, Philip K., Oil Markets in Turmoil, Ballinger Publishing Company, Cambridge, Mass., 1982, p. 146.

[3] Charles River Associates, Inc. Public Policy and Private Petroleum Stockpiling CRA, Boston, Mass., CRA, 1981 pp. 1-1 to 1-4.

While research on government policies to reduce the economic costs of disruptions is abundant, much of it conflicts or addresses different aspects of the problem. Verleger, Mork, Hubbard, ICF, Inc., Rowan and Weyant, Pindyck and Rotemberg, and Resources for the Future are among the authors and institutions that have studied these concerns. The Energy Modeling Forum at Standford University is currently studying the economic effects of a 50 percent oil price shock and various government responses across 14 participating models. Results of this study are expected by June 1983.

Because researchers examine different types of policies, comparison between them is difficult. Government policies studied can be divided into those which are instituted before and after the disruption. Policies instituted before the disruption that prevent economic losses include encouraging private stock buildup in excess of normal levels; predisruption tariffs to lower oil imports; and incentives for technologies which allow easy substitution away from oil use in a disruption. Response policies during a disruption can be categorized as those that mitigate price increases, stabilize the economy, and redistribute income. Price mitigation policies can include price controls, private and public stock drawdown, and incentives to reduce oil demand. Various monetary and fiscal policies have been offered for relieving the economic costs of disruptions. Monetary expansion, disruption tariffs, payroll tax cuts, revenue recycling, and tax incentives for investment are the usual policies discussed in this area. Income redistribution, in terms of preventing the wealth transfer from consuming to producing nations, can be accomplished with a disruption tariff. Revenue recycling and energy emergency assistance programs have been discussed as ways to reduce income transfers from consumers to producers and the government during disruptions.

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[4] Hubbard, R. Glenn and Fry, Robert C., The Macroeconmic Impacts of Oil Supply Disruptions, Harvard University, Cambridge, Mass., 1982, p. 43.

Researchers disagree on the appropriateness of these various government responses to disruptions. One major reason for disagreement is conflicting policy objectives. Objectives such as minimizing inflation and unemployment effects may require conflicting policies. In this example, monetary expansion might be pursued to reduce unemployment, while contraction would be pursued to lower inflation. Response policies often affect more than one goal and must be judged by their effects on a range of objectives. Disagreements arise because of differences in the importance of objectives. Disruption tariffs, for example, encourage stock drawdown, lower oil consumption, and reduce the wealth transfer from consuming to producing nations. The appropriateness of a disruption tariff depends on the importance placed on these objectives and how well it meets them compared to other policies.

THE GAO MODEL

The GAO model closely follows the relationships and uses some of the estimates of Philip Verleger's model outlined in his recent book, Oil Markets in Turmoil. However, we reestimated all but two of Verleger's equations, using somewhat different variables, seasonal adjustments, and extended time periods. These reestimations resulted in substantially different coefficients in many cases. In GAO's version of the model, disruptions produce lower price increases, because our model generates smaller inventory accumulation and larger initial oil demand reductions than Verleger's model.

As in Verleger's model, spot price changes are the driving force in the GAO model. Spot price changes in this monthly model are a function of the ratio of expected-to-actual production. If expected and actual production are equal, spot prices will not change. A disruption is modelled by lowering actual production, raising the expected-to-actual production ratio and thus spot prices.

Inventory accumulation during disruptions causes an upward spiral in spot prices. Stocking up is the result of expected spot price increases, signified by the spread between last period's spot and contract prices. This accumulation raises expected production, again raising the expected-to-actual production ratio, and thus spot prices.

Contract prices are a function of a combination of last period's spot and contract prices. Consumer oil prices and consumption are functions of contract rather than spot prices. Like contract prices, consumer prices respond sluggishly to the disruption. This sluggish response delays the adjustment of consumer oil demand to reduced supplies. Combined with inventory accumulation, excess consumption exerts an upward pressure on spot prices.

As prices rise, the lagged reduction in oil demand lowers expected production, the expected-to-actual production ratio, and eventually spot prices. The GAO Model is summarized below.

Variables

OPAL = Contact price for Arab light oil
SPAL = Spot price for Arab light oil
SPREAD = Difference between spot and contract prices
CONPRICE = Consumer oil product price
INV = Inventory demand
FWPR = Free-world oil production
QE = Expected producton
QHAT = Oil consumption

Equations

(1) Spot Price
SPAL = (SPAL\1) x (QE/FWPR)**2

(2) Contract Price
OPAL + .904xOPAL\1 + .096xSPAL\1

(3) Spread
SPREAD = SPAL - OPAL

(4) Inventory Demand
INV = 113.225 + 3.17925xSPREAD\1 + 0.953258xINV\1

(5) Consumer Product Price
CONPRICE = $6 + OPAL

(6) Oil Consumption
QHAT = 8972.44 - 41.1628xCONPRICE + 0.823993xFWPR\1

(7) Expected Production
QE = QHAT + (INV-INV\1)

ESTIMATION OF CONSUMER OIL PRICES

The models produced spot and contract prices for crude oil, which we converted into consumer oil prices, or prices for gasoline, home heating oil, and residual fuel. Product prices were estimated on the basis of statistical relationships betwen product and crude oil prices. These relationships were estimamted separately for monthly and quarterly results over a recent time period. Consumer prices were ultimately converted from dollars per barrel to cents per gallon units. The equations for converting prices are listed below.

Variables

PCONTRACT = Contract price for crude oil
PSPOT = Spot price for crude oil
PCOF = U.S. refiner's acquisition cost for imported crude oil
PCOCP = U.S. refiner's acquisition cost for composite of domestic and foreign oil
MOGAS = Average retail gasoline price for all types
DIST = Average retail No. 2 Heating oil price
RESID = Average retail No. 6 residual oil price

Equations

(1) U.S. Refiner's Acquisition Cost for Imported Oil (dollars per barrel)

$$PCOF = .614357 + .184278 \text{x} PSPOT = .89825 \text{x} PCONTRACT$$

(2) U.S. Refiner's Acquisition Cost for Composite of Domestic and Foreign Oil (dollars per barrel)

$$PCOCP = PCOF-(.034 \text{x} PCOF)$$

(3) Gasoline Price (cents per gallon)

$$MOGAS = \frac{13.2644 + 1.27384 \text{x} PCOCP}{42} \text{ x } 100$$

(4) Home Heating Oil Price (cents per gallon)

$$DIST = \frac{3.32439 + 1.28428 \text{x} PCOCP}{42} \text{ x } 100$$

(5) Residual Oil Price

$$RESID = \frac{3.33034 = .819528 \text{x} PCOCP}{42} \text{ x } 100$$

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U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON FOSSIL AND
SYNTHETIC FUELS
COMMITTEE ON ENERGY AND COMMERCE
WASHINGTON, D.C. 20515

May 21, 1982

The Honorable Charles A. Bowsher
Comptroller General of the
  United States
441 G Street, NW
Washington, DC 20548

Dear Mr. Bowsher:

As Chairman of the House Subcommittee on Fossil and Synthetic Fuels, I am deeply concerned that disruptions of imported oil supplies threaten our Nation's economy and security. The United States and its allies continue to depend on OPEC for much of their oil, with most of this oil coming from the Middle East and North Africa. Continued reliance on supplies from this politically volatile area leaves our Nation and the Western allies vulnerable to supply disruptions.

Both the 1973-74 Arab oil embargo and the 1979 Iranian oil cutoff demonstrated that even relatively moderate shortages can result in disproportionately large oil price increases which can be devastating to the economy. While U.S. oil losses during the 1979 disruption comprised a very small percentage of total consumption, crude oil prices nearly doubled between 1978 and 1980. This doubling of prices cut economic growth and added to inflation and unemployment.

The Administration's commitment to relying entirely on the market to allocate and set the price of oil during severe supply disruptions was recently reinforced by its rejection of emergency allocation authority. I find this policy alarming because of the great uncertainty surrounding the extent to which U.S. oil prices would rise during such instances in the absence of any countervailing government response.

Before the Nation places its security and economic health entirely at the mercy of a laissez-faire approach to petroleum supply disruptions, the Congress should be aware of the consequences of such a policy. In this regard, the GAO can make a valuable contribution by assessing objectively what is known about the behavior of world oil market price increases during supply disruptions. Your previous three reports on contingency planning written by GAO's Energy Policy and National Security group have been very helpful in Congressional debate on disruptions policy, and I feel that additional work in this area could provide needed assistance to the Congress as it continues consideration of U.S. energy emergency preparedness.

Specifically, I would like GAO to do the following:

-- Identify and assess the adequacy of the research to date on oil price effects of supply disruptions in the absence of U.S. government intervention;

-- Determine the consensus, if any, on the effect shortages have on prices both during and after a disruption;

-- Determine the consensus, if any, on the effects of oil price shocks on the major components of the U.S. economy.

If you find that current research does not adequately address how high prices may rise during an oil shortage or the effects that given increases have on the various components of the economy, please advise us on what key questions remain unanswered and how we might proceed to answer them. Your views on the extent and duration of price increases or on how to study them would be greatly appreciated. Please have your staff contact Committee staff to decide on a work plan.

Sincerely,

Philip R. Sharp
Chairman

PRS:dg

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

For Release at 10:00 a.m.
October 19, 1983

STATEMENT OF
F. KEVIN BOLAND
SENIOR ASSOCIATE DIRECTOR
RESOURCES, COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION
BEFORE THE
SENATE COMMITTEE ON ENERGY AND
NATURAL RESOURCES

Mr. Chairman and Members of the Committee:

We appreciate the opportunity to be here today to discuss the proposed Energy Emergency Preparedness Act Amendments of 1983 (S. 1678) and the nation's ability to coordinate an energy emergency response with its allies. Over the past several years, we have addressed many aspects of this important issue in numerous reports and testimonies. In our appearance before this committee on March 7, 1983, we expressed reservations about the administration's fragmented legal authorities to respond to an oil shortage, and the inadequate level of advance planning to deal with such an emergency.

The bill before this committee, S. 1678, deals with many of the problems we cited, including incomplete emergency response procedures, the prospects of conflicting federal and state laws and policies, and the legal impediments regarding Executive Manpower Reserves. S. 1678 also appears to deal effectively with the problem of the administration's fragmented authority to act in petroleum shortage emergencies by combining such authority into one statute.

We also have suggestions that we believe will further assist in accomplishing the objectives of the proposed legislation. My testimony will briefly discuss the following subjects:

--The Strategic Petroleum Reserve's (SPR's) fill rate and size.

--Readiness to use the SPR.

--The lack of national economic response measures.

--Energy emergency preparedness organizations and procedures.

--U.S. participation in the International Energy Agency (IEA), including lessons learned from the recent test of the IEA system.

Mr. Chairman, let me start by discussing the provisions of S. 1678 as they relate to the SPR.

SPR FILL RATE AND SIZE

Last June we analyzed the impacts of various SPR fill-rate options which are available over the next few years to achieve a 500-million-barrel level.[1] All of these options fill the SPR at a faster rate than the administration's proposed programs, although at different expenditure levels. In the final analysis, the choice involves a value judgement of whether the economic and national security benefits which could result from filling the SPR earlier justifies greater Government expenditures. For example, the analysis showed that a 500-million-barrel level could be reached in fiscal year 1985 if commercial interim storage is used. Restricting the fill rates to amounts that can be stored in permanent storage capacity, or permanent capacity plus onsite interim storage, will delay reaching the 500-million-barrel level until fiscal year 1986. The administration's reduced fill-rate schedule would not achieve 500 million barrels until fiscal year 1987. The cost to the Government varies with the oil price assumptions used. Assuming declining oil prices, filling the SPR at the administration's proposed schedule minimizes total expenditures. If rising oil prices are assumed, however, the administration's proposed schedule results in the highest total expenditures of all oil fill-rate options included in our analysis.

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[1] Letters dated June 13, 1983, to the Chairman, Subcommittee on Fossil and Synthetic Fuels, House Committee on Energy and Commerce; and the Chairman, Subcommittee on Energy and Mineral Resources, Senate Committee on Energy and Natural Resources.

Based on this work, we think that a reasonable objective would be to match the fill rate with the availability of new permanent storage capacity. This objective may not only help minimize total government expenditures if oil prices rise in the future but would (1) provide the added protection of a larger reserve more quickly then the 145,000 barrels per day proposed by the administration and included in S. 1678, (2) avoid reliance on expensive interim storage, and (3) minimize the inefficiency of unused permanent storage capacity. Such an objective would allow a fill rate of about 185,000 to 190,000 barrels per day in fiscal year 1984.

With regard to the SPR's ultimate size, a 750-million-barrel inventory appears to be a generally accepted objective. While we have no current analytical information to support a different level, the question remains whether alternative sizes should be open to consideration in view of changing economic and oil market conditions. We note that in the past, several studies have indicated that an optimum inventory level could be higher than 750 million barrels. Nevertheless, in recent years there have been reduced expectations of future import levels and the expected sources of the imports have changed somewhat.

READINESS TO USE THE SPR

Several provisions regarding our readiness to use the SPR are included in S. 1678. One requires the Secretary of Energy to report annually on how he intends to use the reserve--specifically, on actions taken to assure that (1) the SPR will be used to meet domestic needs, (2) it can be applied to meet our international obligations, and (3) it can be protected from speculation and hoarding.

An annual reporting requirement on SPR use can undoubtedly serve a useful purpose if it provides more information than past reports on this subject. Despite the clear advantages of effective SPR use planning, we have noted in past testimony and reports that the administration's SPR Drawdown Plan and SPR Drawdown and Distribution Report--which we evaluated in a January

1983 report to this committee[2]--provided little specific information about the amount, rate, and timing of SPR use in an emergency. In addition, the administration did not deal with other important policy questions such as the possibility that some SPR oil might be retained in private inventories after it is sold.

DOE has indicated that actions are being taken to resolve these issues. For example, the Secretary of Energy has stated that DOE was developing measures that would appear to meet the requirements of the SPR use provision in S. 1678, including an assurance that SPR oil entering the market during an emergency would be protected against speculation and hoarding.

While we commend DOE's efforts to address these concerns related to using the SPR, we urge that measures taken be as specific as possible. Otherwise, it is doubtful that they would be of much value to the Congress or be effective if and when needed.

SPR drawdown testing

Another provision of S. 1678 concerning the SPR's readiness authorizes the Secretary of Energy to sell SPR oil as part of a drawdown and distribution test. We concur in the merits of testing DOE's ability to physically draw down the SPR. We recognize, however, that there may be practical difficulties in actually selling and distributing large quantities of SPR oil without causing disruptions in oil markets or in DOE's on-going oil fill program.

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[2] Analysis of the Strategic Petroleum Reserve Drawdown Plan and the Strategic Petroleum Reserve Drawdown and Distribution Report (GAO/RCED-83-85, Jan. 3, 1983).

If these difficulties can be overcome, we urge that DOE consider testing the SPR drawdown capability at significant levels over a reasonably sustained period of time to ensure system reliability during an emergency. Such testing is important because the Department's ability to substantially draw down the SPR over a sustained period of time has yet to be demonstrated. During testimony on May 24, 1983, before the Subcommittee on Environment, Energy and Natural Resources, House Committee on Government Operations, we discussed problems and delays in installing automated central control systems at two of the major SPR storage sites. We concluded that these, and other obstacles, "raise concerns about DOE's ability to successfully sustain a major drawdown of the oil reserves in the volumes that could be needed...."

Subsequent to our testimony, a DOE Inspector General report[3] on a 1-day drawdown test at the Bayou Choctaw storage site, in July 1983, stated that the design specifications of the drawdown equipment for a Phase I drawdown were adequate but that problems could be encountered in meeting the higher Phase II drawdown rate. While generally giving high marks for the site operations, the report documented problems at the site, including a lack of standarized systems and components--which makes repairs more difficult--and problems with a new inventory control system which is designed to ensure that adequate spare parts for critical drawdown equipment will be available when needed.

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[3] Drawdown Reliability of the Bayou Choctaw Site of the Strategic Petroleum Reserve, September 28, 1983, U.S. Department of Energy, Office of Inspector General.

DOE has conducted other drawdown tests which have also been of limited duration and quantity. Although one test conducted on April 22-23, 1980, involved a simultaneous drawdown at 3 sites of 1.4 million barrels of oil, no tests have lasted more than 1-2 days and no oil has been physically moved from the SPR into normal distribution channels.

Timing of SPR use

One final aspect of SPR use I would like to discuss concerns the timing of an SPR drawdown. DOE has stated that it intends to use the SPR only as a last resort in the event of a severe oil shortage. Another use of the SPR that may merit further consideration, however, is the use of at least a partial drawdown early during a disruption to help mitigate rapid price increases.

Sudden price increases have proven to be among the most damaging effects of oil supply disruptions. Current research indicates that early drawdown could help to minimize price increases from disruptions. Therefore, early SPR drawdown, particularly if coordinated with similar stock drawdown by our allies, should be considered a viable option in our SPR use plans.

LACK OF NATIONAL ECONOMIC RESPONSE MEASURES

A major gap in DOE's energy emergency preparedness program is the lack of national economic response measures to mitigate the effects of a severe energy supply disruption. Past experience has demonstrated that these effects can be serious, even in a relatively minor shortfall such as the Iranian oil cutoff of

1979. During that disruption, crude oil prices increased two and one-half fold--from $13 to $32 a barrel--between September 1978 and September 1980. The disruption is believed to be a significant factor in the fall of the annual rate of growth of the GNP from a positive 1.2 percent in the first quarter of 1980 to a negative 9.6 percent in the second quarter. It also was a factor in adding about 2 percentage points to inflation in 1979 alone. Furthermore, a recent GAO report concluded that even under today's slack market conditions, large oil supply disruptions could double or even triple oil prices and have serious effects on inflation, economic growth, and employment.[4]

DOE has studied several alternatives to deal with the impacts of a disruption, including standby temporary withholding tax reductions and block grants to the states to recycle revenue from the windfall profits tax or emergency tariffs back into the economy. However, DOE has taken little action to make such measures available in an emergency, relying instead on the free market to handle the economic impacts.

The need for such economic response measures was emphasized by several states during the recent International Energy Agency's test of its emergency sharing system (AST-4). The 10 states participating in the U.S. domestic energy emergency response part of the test were virtually unanimous in their call for federal economic response measures to mitigate the economic impacts of the disruption. The states concluded that the federal government was best situated to deal with the economic consequences (such as unemployment, declining state revenues, and the social costs of high energy prices) associated with rapidly rising oil prices, since federal revenues from the crude oil windfall profits tax would increase significantly due to higher oil prices. Despite the states' concern about the impact of high prices, DOE took no action, citing as reasons the administration's incomplete analysis of the impact of allocation and pricing on the domestic economy and the lack of participation in the test by high level economic policy makers in other federal agencies.

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[4] Oil Supply Disruptions: Their Price and Economic Effects (GAO/RCED-83-135, May 20, 1983).

The states' pointed call for federal action during the AST-4 test underscores the likely intense pressure for national economic response measures which would follow an actual crisis. In our view, if such response measures are not designed now and placed in standby status, we may find ourselves formulating such measures in the turmoil of an actual disruption. A standby national emergency economic response plan may also lessen the likelihood of either the federal government or individual states instituting oil price and allocation controls. Experience from the 1979 Iranian shortfall indicates that such controls have the potential to actually exacerbate the effects of the shortage.

In view of the AST-4 test results and a considerable amount of research by DOE and private organizations examining various aspects of economic response measures, we urge the committee to review this matter during its consideration of S. 1678.

EXTENSION OF ANTITRUST DEFENSE

Subsection 4(a) of the bill would amend subsection 252(j) of the Energy Policy and Conservation Act (EPCA) to extend limited antitrust protection for U.S. oil company participation in IEA activities until June 30, 1985, the date on which EPCA as a whole expires. Existing law provides this protection only until December 31 of this year.

Since IEA was formed, the U.S. government recognized that the International Energy Program (IEP) agreement could not be successfully implemented without the assistance of at least the major U.S. international oil companies; yet the actions required could have anticompetitive consequences and result in antitrust suits against the companies. To obtain and authorize company assistance in carrying out the U.S. obligations under the IEP, EPCA authorized the development and implementation of a voluntary agreement and plan of action. The agreement, administered by DOE but approved and monitored by both Justice and the FTC, sets forth the circumstances under which industry can participate in IEA activities. The plan of action, also to be administered by DOE but approved and monitored by both Justice and the FTC, is to set forth the kinds of specific actions that are authorized for companies to take during an actual emergency. An invited U.S. company that signs the voluntary agreement and plan of action has available to it the statutory defense against any civil or criminal suit brought under Federal or State antitrust laws for actions taken to carry out the agreement or plan, provided the actions were not taken for the purpose of injuring competition.

Many U.S. oil companies maintain that they will not participate in the IEA without the benefit of an antitrust defense. The IEA Secretariat, the U.S. government, and many foreign governments and oil companies maintain that without U.S. oil company participation the viability of the IEA is threatened. However, during AST-4, U.S. antitrust monitoring and recordkeeping requirements covering U.S. oil company involvement in such an exercise were criticized by U.S. and foreign oil companies and the IEA Secretariat as being excessive and burdensome. U.S. antitrust authorities have tried to be responsive within the framework of existing U.S. law.

We do not oppose some extension of the Section 252 antitrust defense, but we believe (1) the Committee should discuss the specific extent of any extension with the FTC and the Justice Department and (2) the Secretary of Energy may want to use existing authority under EPCA to establish an Advisory Committee on IEA matters which could, among other things, serve to assure broad and balanced participation by both large and small oil companies. Concerning the latter, although no oil company has expressed concern, major U.S. oil companies tend to dominate industry participation in IEA activities. They devote more staff and financial resources to IEA activities than other companies. The Advisory Committee would provide a communication vehicle for smaller oil companies, consumers, and other interested parties.

Despite the importance of advance approval of anticipated participating company actions before a crisis occurs, a revised plan of action tailored to the IEA's Emergency Sharing System has not been finalized. Although DOE has made recent progress in developing the plan, it has been in preparation for more than 5 years. To enable companies to know what actions they could take in emergency situations, finalization of this plan should be stressed, particularly in light of the uneasy situation in the Middle East.

ENERGY EMERGENCY PREPAREDNESS ORGANIZATIONS

Section 3 of S. 1678 appears intended to (1) broaden the use of voluntary agreements and plans of action to include a wider range of participants and to be available for domestic as well as international emergencies and (2) resolve legal constraints impeding use of the Emergency Executive Manpower Reserves. We agree with the concept of making effective use of industry expertise and the expertise of other organizations during an energy emergency. However, antitrust and conflict-of-interest waivers in the bill as proposed are very broad. While our work to date has not evaluated the alternatives, we would urge the committee to explore whether the objective could be achieved with more limited exemptions.

Voluntary agreements

The Energy Policy and Conservation Act provides authority for a voluntary agreement to obtain industry assistance for one defined purpose, to carry out U.S. obligations under the International Energy Program. Industry actions and associated anticompetitive risks can be evaluated by reference to the particulars of the provisions of the IEA and its implementing documents, and protections designed to minimize these risks.

S. 1678, on the other hand, would substantially increase the President's authority to enter into voluntary agreements with industry, in exchange for antitrust protection, to facilitate preparation for, or respond to, a domestic or international energy emergency. The particular purposes for which a voluntary agreement might be developed and used are unspecified. Consequently, the associated anticompetitive and other risks cannot be effectively evaluated.

We suggest that the committee consider asking DOE to more precisely define the purposes for which voluntary agreements would be used in an emergency and specify them in the bill. For example, authority might be provided for a voluntary agreement with industry, coupled with antitrust protection, to allow companies to participate in meeting U.S. obligations to provide oil to NATO. Congress would then be in a better position to (1) determine who the anticipated participants in a voluntary agreement would be, (2) evaluate the potential anticompetitive consequences of the agreement, and (3) determine whether the benefits to be gained from the voluntary agreement outweigh the risks of anticompetitive consequences.

Executive manpower reserves

The objective of the manpower reserves is to develop and maintain the capability to quickly augment DOE staff during an energy emergency with experienced industry professionals who can help identify and assess supply and demand problems and assist in coordinating energy production and distribution. As we have frequently noted in the past, major legal problems that have precluded use of the Reserves include the following:

- --Reservists who serve or advise federal officials during an emergency are subject to general conflict-of-interest laws and to additional civil provisions of the Department of Energy Organization Act.
- --Participation of industry officials in the program may expose the officials and their companies to antitrust risks.

The bill provides comprehensive exemptions, to be used at the discretion of the President, to eliminate these barriers. Reservists may be (1) exempted from antitrust and conflict-of-interest and financial reporting laws prior to as well as during an emergency, (2) able to make policy decisions, and (3) used during domestic as well as international energy emergencies.

There are substantial risks associated with these exemptions. For example, reservists would be protected by the exemptions even where they, on behalf of the Government, negotiated contracts with their private employer; provided Government relief or assistance to their private employer; received multiple salary payments from companies other than their own employer while they are working for the Government; used their temporary emergency Government jobs to facilitate price-fixing agreements; or provided favoritism to their private employers during the energy emergency. While providing some waivers for conflict-of-interest restrictions, the Defense Production Act, which presently authorizes the Manpower Reserves, contains explicit provisions to preclude these types of situations. No such protections are included in S. 1687 as drafted. While we support the judicious use of conflict-of-interest and antitrust waivers in emergency situations, care should be taken to establish some parameters.

The administration's Comprehensive Energy Emergency Response Procedures Report noted difficulties involved in defining the extent to which these exemptions should be given. The administration acknowledged the need to balance competing objectives served by the conflict-of-interest and antitrust laws on one hand with the use of industry assistance in energy emergencies on the other. It concluded that "just where this balance should be struck is not yet clear."

We would suggest that DOE could go a long way toward developing more specific waivers of conflict-of-interest and antitrust laws by carefully defining how it intends to use the executive reserves. With these uses in mind, it would be easier to tailor the waivers to meet the need and avoid the use of blanket exemptions.

UPGRADING COMPREHENSIVE PROCEDURES

As proposed, S. 1678 would require the Secretary of Energy to report annually on actions taken to upgrade the administration's emergency response procedures.

We agree with this provision. The usefulness of the report, however, will depend on the completeness and overall quality of the report provided by the executive branch. In our recent analysis of the administration's Comprehensive Energy Emergency Response Procedures Report, we reported that the administration's response lacked required specificity and demonstrated that key parts of the energy emergency preparedness programs were still not ready.

IMPLICATIONS OF AST-4

Although the IEA Emergency Sharing System has never been activated, periodic and limited tests of the system in 1976, and more comprehensive tests in 1978, 1980, and 1983, have been conducted. The recently completed fourth test of the system (AST-4) was designed to determine how well prepared participating countries, including the United States, are to meet their oil sharing obligations under the IEA agreement and what potential problems can be anticipated if the system were activated in a real crisis.[5]

This test provided useful training and other benefits to government, industry, and IEA Secretariat personnel, many of whom had not participated in the previous IEA tests.

However, we have identified several concerns regarding U.S. participation in the test which we would like to bring to your attention. The test revealed a number of key problems which should be addressed if the IEA Emergency Sharing System is to make a significant contribution to reducing the costs and dislocations of an oil supply interruption. In particular, it focused attention on some of the difficulties the United States might face in relying exclusively on market forces to fulfill U.S. international obligations under the IEA Emergency Sharing System and to cope with the economic impacts of a major oil shortage. On the operational level, the management of U.S. participation in AST-4 was marked by inadequate preparation, lack of coordination, and failure to resolve disagreements within the executive branch on important test-related issues. In addition, DOE made several assumptions and decisions which may have unduly reduced the U.S. allocation obligation and inclined companies to make much larger voluntary offers for testing purposes than they would in a real emergency situation, raising questions as to how seriously the U.S. views the sharing system.

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[5] For further elaboration of this test, see Assessment of U.S. Participation in the International Energy Agency's Fourth Test of Its Emergency Sharing Allocation System, (GAO/NSIAD-84-4, Oct. 13, 1983).

Economic response policy

The test demonstrated the substantial economic consequences of relying solely on price to restrain demand. DOE forecast oil prices rising to $98 per barrel, gasoline selling at $2.83 per gallon, substantial reductions in U.S. manufacturing activities and Gross National Product, and significant increases in unemployment and consumer prices. As previously discussed, AST-4 participants from the states strongly felt that the federal government would have to establish and be ready to implement some revenue recycling measures to address the problem.

Fair sharing, oil company participation, and SPR use

DOE assumed certain behavior for the U.S. oil market that was critical to meeting the U.S. oil sharing responsibility under the test. However, the ability of the market to adjust as quickly and smoothly as DOE assumed does not reflect the realities experienced in prior emergencies.

Most U.S. oil companies that actively participate in IEA activities have said that they would not volunteer oil supplies to the IEA Emergency Sharing System unless a program existed to assure that the burden would be shared equitably with their domestic competitors. About 90 percent of voluntary offers made by major oil companies during the test were predicated on the existence of a "fair sharing" program. Therefore, AST-4 clearly showed that some form of a fair sharing program is probably necessary.

Besides major oil companies that have been working directly with the IEA, other U.S. companies may be willing to voluntarily share oil with other IEA member nations. However, the test did not convincingly demonstrate that these companies can make a significant contribution because there were serious doubts about the realism of most offers of oil made by these companies. For example, significant information was missing in three-fourths of the offers made by these companies, so DOE made up or guessed at the missing data. Officials at the IEA quickly recognized these as improbable or erroneous.

The test also raised questions about if and how the U.S. would use the SPR in such an emergency. DOE's decision not to draw down the SPR, and in fact to continue filling it during a considerable part of a simulated major disruption, may reflect the difficulty the U.S. government might experience in deciding when and how to use the reserve in a real crisis.

Reactions by allies and handling of price

Finally, U.S. primary reliance on market forces to cope with the disruption, as well as certain actions taken by the U.S. government during the test, have raised concerns within the IEA and with other IEA countries, about the U.S. commitment to the Emergency Sharing System.

Following the AST-4 test, major IEA participants, including the Secretariat, industry and government groups, and oil market experts, completed individual assessments of the test. Overall, these groups raised several concerns about the viability of the system in a real crisis and U.S. participation in the test. Areas of principal concern cited included the lack of pricing in the test of the voluntary offer process, the impact of the U.S. relying exclusively on oil price increases to achieve demand restraint objectives, the absence of a U.S. fair sharing program, and the problems that arose with the U.S. nonreporting company offers.

The international assessments indicated a need for participating countries to have appropriate demand restraint and fair sharing programs in place if the IEA voluntary offer system is to work effectively in a real emergency. These assessments focused attention on the importance of compatible national emergency systems to the successful operation of the entire international Emergency Sharing System. IEA assessment groups concluded that reliance on unrestrained price escalation would not be in keeping with each nation's commitment to the IEA. They indicated that a U.S. approach that relies on price increases as its principal, if not exclusive, response to a major oil supply disruption presents serious problems for the IEA sharing system.

Price was not included in the simulated international allocation of oil under the IEA sharing system because member country governments and participating oil companies failed to reach agreement on a method for determining the price at which oil would be exchanged in AST-4. However, the price of oil in an international emergency is important to the effective distribution of oil supplies among consuming countries. If the IEA's 21 member countries that are to share oil in a severe disruption cannot agree on a pricing approach, serious questions could be raised about the viability of the Emergency Sharing System.

Before I summarize my statement, Mr. Chairman, I would like to bring one more item to your attention. In our March 7, 1983, testimony, we expressed a concern that the different energy statutes do not use common terms or language to trigger their respective authorities. For example, a "severe energy supply interruption" is the key to utilization of certain provisions of the Energy Policy and Conservation Act (EPCA), the Emergency Energy Conservation Act (EECA), and the Powerplant and Industrial Fuel Use Act. On the other hand, authorities under the Defense

Production Act are generally only available in connection with national defense and defense preparedness activities. The structure of S. 1678 making its new authorities specific to energy emergencies is an improvement. However, it introduces yet two more terms, "domestic energy emergency" and "international energy emergency." Both terms seem very broad and neither term is defined in the bill, unlike "severe energy supply interruption" which is carefully defined in EPCA and EECA. Consequently, it is not clear in what circumstances these new authorities might be used nor do there appear to be constraints on their use.

SUMMARY

I would like to summarize my testimony by re-emphasizing some of our observations. We note that S. 1678 deals with many of the emergency preparedness problems we have cited in past reports and testimony. It also combines emergency preparedness laws into one statute, although the circumstances in which some of its authorities may be used are not entirely clear. In particular, we agree with

--its objective to make effective use of industry expertise,

--the provisions to facilitate SPR drawdown testing, and

--the requirements that the Secretary of Energy report on improvements in DOE's comprehensive procedures.

In some areas, we have made suggestions which we believe would further assist in accomplishing the bill's objectives. Among them:

--A reasonable objective for a SPR fill rate could be to match it with the availability of permanent storage capacity.

--While 750 million barrels is a reasonable objective for the size of the SPR at this point, the question should remain open for further consideration in view of changing economic and oil market conditions.

--The committee should consider whether the objective to effectively use industry expertise could be accomplished with less wide-ranging exemptions from existing antitrust and conflict-of-interest laws.

Finally, we would like to point out a few related matters that we believe warrant the attention of this committee:

--The results of AST-4 surfaced fundamental problems relating to U.S. participation in the IEA and our ability to meet oil sharing obligations. DOE actions in response to this test should be carefully monitored.

--The potential benefits of using the SPR early in a disruption to dampen sharp price increases should be considered.

--DOE should be encouraged to develop national economic response measures to deal with economic dislocations caused by rising oil prices and fuel shortages.

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That concludes my prepared statement. We would be happy to respond to any questions.

JAMES A. MC CLURE, IDAHO, CHAIRMAN

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United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, D.C. 20510

October 24, 1983

The Honorable Charles A. Bowsher
Comptroller General of the United States
General Accounting Office
441 G. Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

In connection with your October 19, 1983 testimony before the Committee on S. 1678 enclosed are additional questions from the minority for the record. Your response by Friday, October 28, 1983, would be appreciated. Your response and any inquiries regarding this request should be directed to the attention of Richard D. Grundy, professional staff member at (224-2564).

Sincerely,

James A. McClure

James A. McClure
Chairman

JAM:nm
Enclosures

Questions for GAO

Executive Manpower Reserves

1) On page 14 of your prepared statement you contrast the safeguards provided in the Defense Production Act with the absence of such safeguards in S. 1678 regarding the Executive Manpower Reserves. Could you speak to other safeguards in the Defense Production Act or other defense-related laws regarding voluntary agreements and plans of action, safeguards which are missing in this legislation before us? Would you prefer to supply that for the record?

2) AST-4

a) The DOE has been accused in the AST-4 test of having assumed a methodology that guaranteed a pre-determined result, namely, the achievement of the U.S. obligations to the IEA but without any intervention by the FEderal Government. Is there any truth in your opinion to that charge?

b) How realistic was the DOE's reliance on non-reporting companies to achieve the U.S. oil-sharing obligation?

To what extent did DOE rely on non-reporting companies to meet the U.S. oil-sharing obligation? We understand that one non-reporting company contributed a disproportionate amount of oil in our oil sharing. Is this true? Please explain.

2)(c) How realistic was DOE's assumption that our SPR was force-majeured? To what extent did that assumption contribute to the U.S. meeting our IEA oil sharing obligation?

3) Had DOE not assumed the force-majeure of our SPR and the involvement of non-reporting companiesin the oil-sharing program would the U.S. have met its obligations to the IEA in AST-4?

4) We understand that some U.S. companies who force-majeured our own SPR, then turned around and were among those non-reporting companies who were persuaded to contribute oil abroad as part of our IEA oil sharing arrangements. Is this true? Please explain.

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5) On Sept. 22,1983, the House Subcommittee on Environment, Energy, and Natural Resources held a hearing on AST-4 in which GAO testified. The State Department was represented there by a Mr. David Burns. Before our Committee the State Department was represented by Mr. E. Allan Wendt who addressed the subject of AST-4. There appears to be some inconsistencies in the State Department's testimony before the House and Senate regarding AST-4, especially on the subject of how realistic the AST-4 test scenario was and the reaction of our IEA partners to our participation in AST-4. Given GAO's intimate knowledge of AST-4 and the context of the whole exercise, please indicate what inconsistencies you see in the State Department's testimony before the House and Senate and explain whether or not you think these inconsistencies, if any, are significant.

Questions for IEA Hearing for GAO

Submitted by Senator Metzenbaum

1) How realistic was U.S. participation in AST-4?

--Specifically, were price, demand restraint, fair sharing and oil company voluntary offers predicated on questionable assumptions by the Department of Energy?

2) Were there any problems with U.S. antitrust monitoring in AST-4? Please explain fully.

GAO should address ISAG members involvement with their respective companies during the voluntary offer period of the test.

3) How extensive is major U.S. oil company dominance of IEA activities? What can be done to provide a more balanced private sector advisory input?

4) Does Section 251 of EPCA provide sufficient authority for the U.S. to establish a fair sharing system to meet its IEA obligations?

5) What is the status of the revised plan of action being developed for the U.S. government? Are there any areas of particular concern that need to be addressed?

6) Does the IEA continue to limit the terms of the secretariat employees to 3-5 years?

7) What is the status of GAO's overall follow-up report on U.S. participation in IEA that I have requested?

8) How extensive is current Justice and FTC antitrust monitoring of U.S. oil company involvement in the IEA?

9) What is the status of the U.S. government response to weaknesses identified in U.S. participation in AST-4?

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

November 3, 1983

The Honorable James A. McClure
Chairman, Committee on Energy and
Natural Resources
United States Senate

Dear Mr. Chairman:

Your letter of October 24, 1983, requested that we submit answers to five questions from the minority for the record. These questions concern my testimony on energy emergency preparedness provided to the Committee on October 19, 1983. Enclosed are our answers to these questions. In addition to these answers, Senator Howard M. Metzenbaum requested that GAO provide answers to other questions and formally submit them to the Committee for inclusion in the official record. Our answers to these questions are also enclosed.

Sincerely yours,

F. Kevin Boland
Senior Associate Director

Enclosures (2)

QUESTIONS AND ANSWERS
FOLLOWING THE
OCTOBER 19, 1983 HEARING
BEFORE THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE
WITNESS: F. KEVIN BOLAND
SENIOR ASSOCIATE DIRECTOR
RESOURCES, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION
U.S. GENERAL ACCOUNTING OFFICE

GAO ANSWERS TO QUESTIONS FROM SENATOR MCCLURE FOR RECORD OF SENATE ENERGY AND NATURAL RESOURCES COMMITTEE HEARINGS OF OCTOBER 19, 1983

1. On page 14 of your prepared statement you contrast the safeguards provided in the Defense Production Act with the absence of such safeguards in S. 1678 regarding the Executive Manpower Reserves. Could you speak to other safeguards in the Defense Production Act or other defense-related laws regarding voluntary agreements and plans of action, safeguards which are missing in this legislation before us? Would you prefer to supply that for the record?

The only statutes of which we are aware that authorize the U.S. Government and industry to enter into voluntary agreements and plans of action, coupled with antitrust protection, to further a Government objective are the Defense Production Act (DPA) and the Energy Policy and Conservation Act (EPCA). The purpose in both instances is to enlist and facilitate voluntary industry assistance in, or preparation for, a crisis; the mechanism is designed to maximize Government-industry coordination and cooperation, yet retain sufficient Government monitoring and regulatory controls to minimize anticompetitive consequences.

The statutory provisions in section 708 of the Defense Production Act, as amended, 50 U.S.C. App. § 2158, and section 252 of the Energy Policy and Conservation Act, as amended, 42 U.S.C. § 6272, governing voluntary agreements and plans of action have the same basic design, although they differ in some particulars. As a generalization, section 252 of EPCA is somewhat more specific and stringent in its Government monitoring and regulatory requirements. Section 252 of EPCA has worked well in the context of the International Energy Program. The provisions of S. 1678 tend to follow closely the provisions of section 252 of EPCA, and in substance are almost identical with two significant exceptions.

First, section 252 of EPCA provides authority for a voluntary agreement to obtain industry assistance for one defined purpose, to carry out U.S. obligations under the International Energy Program. Industry actions and associated anticompetitive risks can be evaluated by reference to the particulars of the provisions of the IEP and its implementing documents, and protections designed to minimize risks. S. 1678, on the other hand, would substantially increase the President's authority to enter into voluntary agreements with industry, in exchange for antitrust protection, to facilitate preparation for, or respond to, any "domestic or international energy emergency." The particular purposes for which a voluntary agreement might be developed and used are unspecified. Consequently, the associated anticompetitive and other risks cannot be effectively evaluated in advance.

We recognize that the provisions of section 708 of the DPA are also broad in this respect. The President may enter into voluntary agreements "upon a finding that conditions exist which may pose a direct threat to the national defense or its preparedness program." However, when one is dealing with only one potential threat, i.e., energy, one should be better able to specify the purposes for which a voluntary agreement may be desirable.

A second feature in which S. 1678 differs from both section 252 of EPCA and section 708 of DPA are the circumstances in which a meeting held to carry out or develop a voluntary agreement or plan of action may be closed. Section 252 only authorizes closed meetings if the President finds that a wider disclosure would be detrimental to the foreign policy interests of the United States. Section 708 of DPA authorizes closed meetings if disclosure of the matters to be discussed at the meeting would be detrimental to the foreign policy or national security interest of the United States. S. 1678 authorizes meetings to be closed "if the President finds that a wider disclosure would be detrimental to the interests of the United States." We believe this is too broad, and that closed meetings should be authorized only if wider disclosure would be detrimental to the "foreign policy or national security" interests of the United States.

2a. The DOE has been accused in the AST-4 test of having assumed a methodology that guaranteed a pre-determined result, namely, the achievement of the U.S. obligations to the IEA but without any intervention by the federal government. Is there any truth in your opinion to the charge?

Our analysis indicates that DOE made several assumptions during the test that may have unduly reduced the U.S. allocation obligation and induced companies to make much larger voluntary offers for testing purposes than they would in a real emergency situation.

DOE's policy approach was to rely primarily on market forces to cope with the disruption. DOE did not want to employ price controls, regulations to curb consumption, or other emergency authorities. To accomplish this and simultaneously meet IEA obligations, it was necessary that price go up sufficiently to reduce U.S. consumption to a level where companies would have surplus supplies and be willing to sell that oil overseas.

Immediately following receipt of the IEA disruption scenario, DOE used its Petroleum Allocation Model to determine that the United States would have to reduce its oil consumption by 2.4 million barrels per day (MMB/D) to meet its IEA commitments. DOE then used its Oil Market Simulation model to project that oil prices would have to rise to a market-clearing price of $98 per barrel in the United States (average price of crude oil landed in the United States) to achieve that reduction. In making this calculation, DOE made a number of simplifying assumptions.

First, DOE assumed that the $98 per barrel price would be realized within two months, from a base price of $38 per barrel. Oil purchasers were assumed to adjust their consumption downward in aggregate by the exact amount (2.4 MMB/D) required to equal the U.S. supply right within the same two month period.

Second, DOE assumed that oil companies, oil suppliers, and oil consumers would not engage in substantial stock building --even though the IEA disruption scenario stipulated great uncertainty about future availability of oil supplies and that oil inventories were heavily reduced by the end of March.

Third, DOE assumed that the $98 price would also clear the world market within the same two months. DOE postulated that other IEA countries would offset 1.7 MMB/D of their shortfall by successfully imposing regulatory (i.e., non-market) demand restraint measures and/or by drawing down emergency reserves. This assumption was necessary because DOE's analysis showed that $98 was not enough to balance total world supply and demand. However, under the IEA formula, other IEA countries were required to reduce consumption by 2.7 MMB/D. If they accomplished a 2.7 MMB/D reduction by regulatory demand restraint measures and the use of emergency reserves, the world oil price would not have risen to $98 per barrel. In this case, DOE's market approach would not reduce U.S. consumption sufficiently for the U.S. to meet its IEA commitments.

DOE presented its results to U.S. reporting companies and to all other U.S. AST-4 participants before the companies had to make any decisions about voluntary offers. In presenting its results, DOE did not describe the simplifying assumptions that it had made, with the exception of its assumption that stock building would not occur. In addition, DOE provided the companies with its forecast of prices and consumption through June. The forecast showed price leveling off at $98 per barrel from May through June, and consumption falling further in June. DOE told recipients that the information was "guidance" that may be considered an integral part of the disruption scenario.

This guidance may have inclined companies to make larger offers than they otherwise would, since the guidance described a situation in which U.S. demand was less than U.S. supply and the world oil price had stabilized.

However, DOE's assumption that the world, U.S. and other IEA country oil markets would make a rapid and smooth adjustment to a major world oil supply disruption is questionable. For example, the adjustment process evidenced during the 1973-74 Arab oil embargo and the 1978-79 Iranian oil supply interruption was not nearly as quick or smooth, and these disruptions were substantially smaller in size.

We recently reported,[1] based on a GAO model, that oil prices could continue rising during a severe disruption and for several months after it ended. We also found that private oil stock building is a key factor in the upward price spiral accompanying disruption. However, as noted above, DOE assumed no substantial stock build-up. If stock build-up did occur, the build-up could have equalled or exceeded the 1.3 MMB/D of surplus domestic oil supplies which DOE assumed would quickly result from falling U.S. demand. If this happened, surplus supplies would not be available to help the U.S. meet its allocation obligation.

Other assumptions and actions taken by DOE and which influenced the U.S. ability to meet its IEA oil sharing obligations are as follows. First, DOE assumed that most oil imported into the United States under contract for the SPR was cut off as a result of suppliers invoking force majeure. This assumption reduced the U.S. allocation obligation by 54 percent, and thus greatly increased the likelihood that U.S. company voluntary offers to the IEA would meet the U.S. obligation. (For further discussion on this point, see the answer to question 2c below.) Second, DOE told non-reporting companies to assume that they could get the best price possible in selling oil as a voluntary offer to another IEA country. Third, in soliciting voluntary offers from non-reporting companies, DOE did not request certain important information needed to determine whether companies could realistically make offers within the prescribed time period and whether specific offers could be successfully matched (see 2b below). Fourth, although DOE did not establish a fair sharing system to assure that companies making voluntary offers would not suffer disproportionately relative to other companies, DOE waited until after the reporting companies made their offers to the IEA before advising the companies of its action.

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[1] U.S. General Accounting Office, Oil Supply Disruptions: Their Price and Economic Effects (GAO/RCED-83-135, May 20, 1983), pp. 16, 19.

2b. How realistic was the DOE's reliance on non-reporting companies to achieve the U.S. oil-sharing obligation?

> To what extent did DOE rely on non-reporting companies to meet the U.S. oil-sharing obligation? We understand that one non-reporting company contributed a disproportionate amount of oil in our oil sharing. Is this true? Please explain.

Total net voluntary offers made by non-reporting companies were 5.2 million metric tons (MMT), or about 1.7 times greater than the offers made by U.S. reporting companies. Non-reporting companies' net offers which were successfully matched by the IEA were 2.2 MMT, also greater than those of the reporting companies (i.e., 1.8 MMT). Without the non-reporting company offers, the United States would have fallen substantially short of its allocation obligation (see answers to questions 2c and 3 below). Thus, DOE relied importantly upon the non-reporting companies.

These results were quite surprising, since non-reporting companies had not previously participated in IEA tests of the emergency sharing system and since they accounted for less than one-third of U.S. oil imports and less than two/fifths of total U.S. oil supplies.

In our view, DOE's reliance on the offers by non-reporting companies was not very realistic because of the way by which DOE generated them. In soliciting offers from non-reporting companies, DOE did not request certain important information needed to determine whether non-reporting companies could realistically make offers within the prescribed time period and whether specific offers could be successfully matched with companies in other countries in need of oil. More importantly, DOE did not instruct the non-reporting companies that before deciding whether and how much they could offer, they should first reduce their stock levels by the assumed inventory drawndown of 22 percent and calculate whether and how their supply positions had been reduced by the simulated disruption of oil in specific producing countries. Such adjustments could have critically affected a company's willingness and ability to make voluntary offers and the size of its offers.

Our analysis showed:

--Significant information was missing for three quarters of the offers made by non-reporting companies. Before forwarding the offers to the IEA,DOE made estimates based upon DOE staff expertise of what might be realistic information for the missing data.

--Some of the non-reporting companies' offers submitted to the IEA, with data added by DOE, were quickly recognized as improbable or erroneous by IEA industry experts who were checking the offers.

--One non-reporting company accounted for more than two-thirds of all non-reporting company offers. The company provided DOE with minimal information on its offers. When the IEA raised questions, DOE sought to secure additional information from the company. However, a company official indicated that they did not have sufficient time to examine their historical records. To deal with this problem, the original offers were rejected and the IEA and its Industry Supply Advisory Group simulated new offers by making their own best estimates about the missing data.

--Doubts remain about the realism of the offers made by the company discussed above. For example, the company offered more oil than the entire U.S. allocation obligation for the test period, and more oil than the combined net voluntary offers of all reporting companies. Moreover, the total oil offered by this company was greater than all the oil it imported into the United States during 1981. According to a company official, they did not adjust their stocks downward by 22 percent, as required by the IEA disruption scenario procedures, before deciding whether and what offers to make. And, the company did not reduce its supplies to account for oil lost from countries whose oil production had been disrupted. Finally, a company official told us that its offers were predicated solely on the assumption that it could get a better price through the voluntary offers. If it could have gotten a better price in the United States, it would have done so.

--In at least 7 cases DOE combined offers by two or more companies and/or offers of products in a variety of locations (frequently widely separated), and represented the result as a single offer available at a particular port.

2c. How realistic was DOE's assumption that our SPR was force-majeured? To what extent did that assumption contribute to the U.S. meeting our IEA oil sharing obligation?

During AST-4 DOE assumed that most oil imported into the United States under contract for the SPR was cut off as a result of suppliers invoking force majeure. "Force majeure" is a term of law referring to an irresistible force or act of God that may justify the discharge or nonperformance of a party's contract obligations. Under DOE's assumption, the involved companies (all non-reporting companies) maintained that failure to deliver the oil was an event beyond their control and they were unable to fulfill their contracts.

While it is possible that some companies selling foreign oil to the United States might have cause to invoke force majeure (i.e., if the oil they intended to sell to the SPR was directly cutoff owing to the AST-4 supply disruption), the assumption that this would happen to most of the oil being imported for the historical period defined by the test was questionable. The large majority of oil affected by the force majeure assumption was coming from countries whose oil production was not disrupted. In fact, over two-thirds of the oil originated in the United Kingdom, a non-disrupted country and a major U.S. ally and IEA member country.

The force majeure assumption implied that the British Government might cut off or sanction a cut-off of supplies in an international energy crisis. The decision was not coordinated with the United Kingdom and the British Government refused to accept the U.S. assumption and thus would not modify its oil data submitted to the IEA to show a commensurate decrease in its exports to the United States.

The assumption significantly reduced the U.S. allocation obligation, and as it turned out, enabled the United States to meet its allocation obligation. Without the force majeure assumption, the U.S. allocation obligation would have been 6.8 million metric tons (MMT). Net matched voluntary offers by all U.S. companies (reporting and non-reporting companies) equalled about 4.1 MMT, which represents only about 60 percent of the obligation. With the force majeure assumption, the obligation was reduced by 54 percent, to 3.1 MMT. Thus, the United States not only met but exceeded its obligation.

3. Had DOE not assumed the force-majeure of our SPR and the involvement of non-reporting companies in the oil-sharing program would the U.S. have met its obligations to the IEA in AST-4?

As discussed above under question 2c, without the force majeure assumption alone, the United states would not have met its allocation obligation. In that case, net matched offers would have equalled only about 60 percent of the obligation.

Without both the force majeure assumption and involvement of the non-reporting companies, the United States would have fallen even further short. Reporting company net matched voluntary offers equalled 1.8 million metric tons (MMT). This represents only 26 percent of a 6.8 MMT allocation obligation.

With the force majeure assumption, but no participation by non-reporting companies, the 1.8 MMT matched offers of reporting companies equal only 58 percent of the 3.1 MMT U.S. allocation obligation.

4. We understand that some U.S. companies who force-majeured our own SPR, then turned around and were among those non-reporting companies who were persuaded to contribute oil abroad as part of our IEA oil sharing arrangements. Is this true? Please explain.

As expressed, this is not fully accurate, since it suggests an action by some non-reporting companies that did not occur. What did happen is that some non-reporting companies that contributed oil were some of the same companies which DOE assumed had declared force majeure with regard to oil deliveries to the SPR.

The force majeure assumption was made by DOE, not by the reporting companies. Furthermore, as we understand it, DOE did not discuss or coordinate its assumption with the affected non-reporting companies.

Q. 5. On Sept. 22, 1983, the House Subcommittee on Environment, Energy, and Natural Resources held a hearing on AST-4 in which GAO testified. The State Department was represented there by a Mr. David Burns. Before our Committee the State Department was represented by Mr. E. Allan Wendt who addressed the subject of AST-4. There appears to be some inconsistencies in the State Department's testimony before the House and Senate regarding AST-4, especially on the subject of how realistic the AST-4 test scenario was and the reaction of our IEA partners to our participation in AST-4. Given GAO's intimate knowledge of AST-4 and the context of the whole exercise, please indicate what inconsistencies you see in the State Department's testimony before the House and Senate and explain whether or not you think these inconsistencies, if any, are significant.

A. 5. Mr. David Burns is Director of Energy Consuming Country Affairs at the State Department. Mr. Burns chaired the IEA AST-4 Test Design Group which was the principal IEA Government/Industry/Secretariat group responsible for test separation. He is the principal U.S. delegate to the IEA's Standing Group on Emergency Questions (SEQ). As Design Group chairman, he was a member of a control group composed of the Executive Director of the IEA, the Chairman of the SEQ and the Chairman of the Industry Advisory Board which was responsible for developing the disruption scenario for AST-4. Mr. E. Allan Wendt is the Deputy Assistant Secretary of State for International Energy Policy and Mr. Burns' immediate supervisor.

Mr. Burns responded to questions of AST-4 from the Chairman of the House Government Operations Subcommittee at September 22, 1983, hearings on the IEA test. The general thrust of Mr. Burns' response are reflected below.

He indicated that:

--he and other representatives of the IEA consider the AST-4 disruption scenario to have been very realistic and reflective of the current situation in the Middle East.

--the State Department initially supported inclusion of pricing in the voluntary offer segment of AST-4 because its inclusion would have made the test even more realistic and would have reflected a U.S. commitment to the IEA.

--some members of the IEA (Japan, the United Kingdom, Germany, Italy, Canada, Denmark, and Ireland) were critical of the way the U.S. participated in AST-4. They were particularly upset with (a) U.S. exclusive reliance on increased oil prices as its demand restraint mechanism, (b) the absence of a fair sharing system (c) the credibility of non-reporting company voluntary offers, and (d) the force majeuring of SPR-destined oil from the United Kingdom. Overall these other members of the IEA were concerned about the continued U.S. commitment to the IEA based on U.S. test performance.

--he doubted that the existing SPR drawdown plan would adequately provide for an effective fair sharing system, particularly in light of competing domestic interests. He also indicated there was U.S. oil company concern over the absence of a fair sharing system and expressed his doubts that these companies would offer oil abroad via the IEA system in a real emergency without an acceptable fair sharing program.

In a prepared statement before the Senate Energy and Natural Resources Committee on October 19, 1983, Mr. Wendt emphasized that AST-4 was meant to be a test of procedures and not policies. He maintained that the test cannot tell us whether the SPR should have been used or whether the U.S. should have used a fair sharing system. He indicated that the test (a) raised these emergency preparedness issues for public discussion, (b) uncovered areas for improvement in U.S. participation; and (c) gave rise to some criticism at home and abroad. He acknowledged the importance of fair sharing to U.S. oil companies' participation in the IEA and the importance of using the SPR in a real emergency. He reiterated the basic U.S. energy emergency policy of relying on market forces, and, if necessary being supplemented by SPR drawdown and such other measures as necessary to meet our obligations to the IEA system. While he emphasized that the U.S. approach to emergency preparedness is sound, he indicated there may be some room for improvement in procedures and that the U.S. is now examining how such improvements might be made within the context of U.S. primary reliance on market forces.

GAO ANSWERS TO QUESTIONS FROM SENATOR METZENBAUM FOR RECORD OF SENATE ENERGY AND NATURAL RESOURCES COMMITTEE HEARINGS OF OCTOBER 19, 1983

Q. 1) How realistic was U.S. participation in AST-4? Specifically, were price, demand restraint, fair sharing, oil company voluntary offers predicated on questionable assumptions by the Department of Energy?

A. 1) Generally, U.S. exclusive reliance on market forces to respond to the simulated disruption in AST-4 raised questions about the ability of the U.S. in a real situation to meet its international obligations under the IEA Emergency Sharing System and cope with the economic impacts of a major oil shortage by employing such an approach.

It is questionable whether total reliance on rising prices without the additional use of voluntary and mandatory demand restraint programs could quickly and effectively achieve the U.S. demand restraint obligation.

Most of the U.S. oil companies that normally participate in the IEA system have stated that they would not make voluntary offers in a real emergency without the existence of a domestic fair sharing system. Of the 14 reporting companies that made voluntary offers in AST-4, 10 either told DOE well before the test that fair sharing would be necessary to induce them to make voluntary offers through the IEA system and/or specifically assumed during the test that a fair sharing system was in place. Thus 88 percent of net reporting company voluntary offers and 95 percent of their net matched offers were predicated on some kind of fair sharing system.

Non-reporting companies made voluntary offers substantially greater than reporting companies' total net offers of 2.9 MMT but the credibility of their offers is questionable for a number of reasons. First, non-reporting companies account for less than one-third of U.S. oil imports and less than two-fifths of total U.S. oil supplies. Therefore, these companies made voluntary offers in excess of reporting company offers while representing a substantially less significant percentage of the U.S. oil market. Second, DOE did not request certain important information from non-reporting companies that is required by the IEA for making voluntary offers. Third, DOE did not instruct the non-reporting companies to adhere to basic test assumptions concerning reduced stocks levels and disrupted supplies before making their voluntary offers. And finally our analysis of non-reporting companies shows:

--Significant information was missing for three-quarters of the 52 offers made by non-reporting companies. Before forwarding the offers to the IEA, DOE made estimates, based upon DOE staff expertise, of what might be realistic information for the missing data.

--Some of the non-reporting companies' offers submitted to the IEA, with data added by DOE, were quickly recognized as improbable or erroneous by IEA industry experts who were checking the offers.

--One non-reporting company accounted for more than two-thirds of all non-reporting company offers. The company provided DOE with minimal information on its offers. When the IEA raised questions, DOE sought to secure additional information from the company. However, a company official indicated that they did not have sufficient time to examine their historical records. To deal with this problem, the original offers were rejected and the IEA and its Industry Supply Advisory Group simulated new offers by making their own best estimates about the missing data.

--Doubts remain about the realism of the offers made by the company discussed above. For example, the company offered more oil than the entire U.S. allocation obligation for the test period, and more oil than the combined net voluntary offers of all reporting companies. Moreover, the total oil offered by this company was greater than all the oil it imported into the United States during 1981. According to a company official, they did not adjust their stocks downward by 22 percent, as required by the IEA disruption scenario procedures, before deciding whether and what offers to make. And, the company did not reduce its supplies to account for oil lost from countries whose oil production had been disrupted. Finally, a company official told us that its offers were predicated solely on the assumption that it could get a better price through the voluntary offers. If it could have gotten a better price in the United States, it would have done so.

--In at least 7 cases DOE combined offers by two or more companies and/or offers of products in a variety of locations (frequently widely separated), and represented the result as a single offer available at a particular port.

For further information, see the GAO answer to question 2a of Senator McClure. Also, more detailed information can be found in our report, "Assessment of U.S. Participation In The International Energy Agency's Fourth Test Of Its Emergency Sharing System," GAO/NSIAD-84-4; October 13, 1983.

Q. 2) Were there any problems with U.S. antitrust monitoring in AST-4? Please explain fully. GAO should also address ISAG members involvement with their respective companies during the voluntary offer period of the test.

A. 2) During AST-4, U.S. antitrust monitoring and recordkeeping requirements covering U.S. oil company involvement in such an exercise were criticized by U.S. and foreign oil companies and the IEA as being excessive and burdensome. The following excerpt from the IEA's Industry Supply Advisory Group's AST-4 Assessment illustrates the basis for criticism of U.S. antitrust monitoring and recordkeeping in the test:

> "The legal requirements of the U.S. Government during AST-4 represented continued improvement from AST-3 but remained somewhat burdensome. The legal requirements of the E.C. Commission posed no problems in either of these tests.
>
> "In accordance with the U.S. Government clearance, U.S. observers attended all meetings of ISAG as a whole, of the ISAG subgroups and of the ISAG Manager or Deputy Manager and the Group Heads. In addition, most of these meetings were recorded by a court reporter retained by DOE. The number of U.S. observers present at regularly scheduled meetings or subgroup meetings, generally held early each day, is felt to have been excessive and unnecessary for the observers' task of record keeping. For example, four U.S. observers from as many as four departments and agencies, plus a court reporter, were present to monitor the activities of one or two U.S. ISAG members at the daily managers' or group meetings. As a result, the meetings took on a degree of formality foreign to the normal flow of discussion and this undoubtedly adversely influenced the conduct of business. Moreover, the requirement for U.S. observers to be present generally inhibited Group Heads from calling impromptu, brief meetings on either test or administrative matters.
>
> "The matching of voluntary offers, with 10 or more supply experts in the room, data displayed on the viewing screen, and computer formats spread about the room, is an informal process with many activities and conversations occurring spontaneously. To facilitate their record-keeping mandate, U.S. observers asked that simultaneous side conversations (and hence activities) be minimized. This was somewhat disruptive of the process of analyzing and

> selecting voluntary offers. U.S. ISAG members kept a daily log of unwritten communications (both direct and by telephone) with other ISAG members, NESOs (other than the U.S. NESO) and Reporting Company Personnel. These were a nuisance to fill in, but were not a significant burden except during the rushed voluntary offer portion of the test when it was disruptive of the normal train of thought to have to take "time off" to bring records up to date.
>
> "The U.S. clearance letter for AST-4 required that U.S. members provide U.S. Government Observers with copies of any written communications related to AST-4, prepared or received by them, within one working day. The E.C. clearance letter also required that copies of documents prepared or received by ISAG members be provided to the E.C. observer. During AST-4, the U.S. and E.C. observers agreed to obtain copies of correspondence through the Secretariat. In turn, the ISAG Manager instructed all ISAG Members to pass their correspondence through the Secretariat communications network for proper recording and distribution, in order to ensure that such observers received the required copies. The Secretariat also agreed to cross-check its list of correspondence periodically with a list provided by the U.S. observers, providing a further check for the U.S. Government observers as to the completeness of their file. This arrangement greatly reduced the burden on ISAG, while shifting an added burden to the Secretariat staff to copy and distribute the extra copies of each document involved."

U.S. antitrust representatives responded to criticisms of their AST-4 activities by stating that such comments do not take into account the responsibility imposed by law in the United States on the Departments of Energy, Justice and State and on the Federal Trade Commission. Antitrust monitoring should be viewed in the context of the statutory framework. Although post-test assessment reports note the number of U.S. observers present at meetings, they do not reflect the importance to each agency of the meetings it may attend. It is necessary that representatives of each agency understand what is going on. The daily meetings held by the ISAG Manager are particularly important in that regard. It is also important that U.S. observers be trained in the operation of the system. U.S. antitrust officials emphasize that it should be recognized that the United States has made a substantial improvement in the restrictions and requirements it has imposed in succeeding tests. They also reported that on some occasions during AST-4 the presence of a number of U.S. observers at a meeting was at the request of counsel for the companies, as, for example, when a number of conversations were taking place at once during the voluntary offer matching process or when a number of working groups were functioning at the same time. They reported that on one occasion a number of uncontrolled side discussions had developed. The U.S. observers did not want to require that the ISAG members keep records of those discussions, so it sent more observers to the conference room.

Antitrust officials have stated that the United States will consider any proposal to streamline the antitrust monitoring process.

The Head of the IEA Test Design Group who was the head of the U.S. post-test assessment delegation, supported the U.S. antitrust monitoring position. He suggested that the individuals who have been charged with carrying out U.S. law have done a good job. The Deputy Executive Director of the IEA has stated that the United States has made progressive improvements over each test in modifying antitrust recordkeeping and monitoring practices. He has suggested, however, that further streamlining of procedures should be pursued.

A major U.S. oil company official during an IEA post-test assessment meeting also pointed out that crowded conditions during AST-4 made the presence of antitrust observers more apparent than it would otherwise have been. He stated that the observers had done a good job and suggested that the more they learn about the allocation process the better off everyone will be.

The Industry Supply Advisory Group (ISAG) is a group of up to 23 representatives from IEA participating oil companies that will be located at IEA headquarters in Paris during an emergency. In the event of the activation of the IEA Emergency Sharing System, as was simulated in AST-4, the ISAG under the guidance of the Executive Director of the IEA, will coordinate voluntary rearrangements of supplies by IEA participating companies, including independent development of transactions in order to better direct supplies to meet IEA-calculated supply rights. Oil company officials who serve on the ISAG, function as independent technical experts and not as representatives of their companies. The ISAG manager and deputy manager coordinate the day-to-day activities of the three ISAG sub-groups: Supply Coordination, Country Supply, and Supply Analysis Groups. During AST-4 the ISAG was composed of representatives from the following IEA participating oil companies:

Industry Supply Advisory Group with Company Membership by its Subgroups

Texaco Inc. (ISAG Manager)
The British Petroleum Co., Ltd. (Deputy Manager)

A. Supply Coordination Group
Shell International Petroleum Co., Ltd., (Head)
* Mobil Oil Corporation
VEBA OEL, A.G.
* Exxon Corporation
* Phillips Petroleum Company
* Atlantic Richfield Company (ARCO)
Ente Nazionale Idrocarburi (ENI)
* Standard Oil Company of California (SOCAL)
* Amerada Hess Corporation
Statoil

B. Country Supply Group
Petro-Canada Ltd. (Head)
Petroleum Association of Japan/Petroleum Producers Association of Japan
Ente Nazionale Idrocarburi (ENI)
* Cities Service Company
* Standard Oil Company of Ohio (SOHIO)
Mabanaft GMBH

*U.S. oil companies.

During the voluntary offer segment of AST-4, members of the ISAG's Supply Coordination Group were responsible for communicating with participating oil companies about their respective voluntary offers of oil. Several U.S. members of the group, in addition to being responsible for communication on voluntary offers with other oil companies, were also responsible for communication with their own respective companies. U.S. antitrust monitors expressed some concern over the potential for favoritism to take place and anticompetitive practices to occur in such a situation during a real emergency. On the other hand, representatives of these companies contend that the overall effectiveness and efficiency of the voluntary offer process is enhanced by having ISAG members contacting their own respective companies. They add that the ISAG member's knowledge of his company makes it easier to facilitate the necessary communication and coordination essential to the successful operation of the voluntary offer process. During the AST-4, several U.S. ISAG Supply Coordination Group members were able to use their understanding of their own respective companies' supply management system to facilitate swaps between reporting companies and national government (NESO) non-reporting company voluntary offers. DOE and U.S. antitrust authorities are actively pursuing this issue. They have requested specific comments in conjunction with the draft Plan of Action which has just been released for public comment. They have asked the following questions:

> "2. At present, it is possible for U.S. ISAG members to be assigned as liaison with their own companies during the voluntary offer process. How important is such an assignment to the efficiency of the voluntary offer process? What risks to competition may it pose?"

Q. 3. How extensive is major U.S. oil company dominance of IEA activities? What can be done to provide more of a balanced private sector advisory input?

A. 3.

The IEA Industry Advisory Board (IAB) is composed of 18 representative international oil companies from Europe, Asia and North America. Its principal function is to provide advice to the IEA Standing Group on Emergency Questions (SEQ) on the design and implementation of emergency oil allocation procedures and information systems. The five continuing IAB members from the United States are Exxon Corporation, Gulf Oil Corporation,[1] Mobil Oil Corporation, Standard Oil Company of California (Socal) and Texaco Inc. Standard Oil Company of Ohio (SOHIO) and Champlin are the 2-year rotating U.S. member companies.

Though a number of matters are raised and discussed in the IAB alone, much of its work is first referred to and developed by one of its two active subcommittees: Subcommittee A, which deals with technical aspects of the allocation system, and Subcommittee C, which is concerned with legal questions facing the IAB and certain peripheral issues. Meetings of the IAB (and its subcommittees) and the SEQ are usually held sequentially.

The current membership of the IAB and its subcommittees is as follows:

Industry Advisory Board

Ente Nazionale Idrocarburi (ENI), Chairman
*Atlantic Richfield Company
British National Oil Corp.
The British Petroleum Co. Ltd.
*Standard Oil Company of Ohio (SOHIO)
*Exxon Corporation
*Gulf Oil Corporation
*Mobil Oil Corporation
*Champlin
OMV Aktiengesellschaft
Petro-Canada Ltd.
Petrofina S.A.
Petroleum Association of Japan/Petroleum Producers Association of Japan
Shell International Petroleum Co. Ltd.

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[1] Gulf Oil Corporation has not actively participated in the IAB for over 1 year, but it continues to retain its membership in the IAB.

- * Standard Oil Company of California (SOCAL)
- Statoil
- * Texaco Inc.
- VEBA Oel, A.G.

Subcommittee A

- Shell International Petroleum Co. Ltd., Chairman
- The British Petroleum Co. Ltd.
- Ente Nazionale Idrocarburi (ENI)
- * Exxon Corporation
- * Gulf Oil Corporation
- * Mobil Oil Corporation
- * Standard Oil Company of California
- * Standard Oil Company of Ohio
- Statoil
- * CONOCO
- * Sun Company
- * Texaco Inc.
- VEBA Oel, A.G.

Subcommittee B

[Inactive]

Subcommittee C

- * Exxon Corporation, Chairman
- * CONOCO
- The British Petroleum Co. Ltd.
- Ente Nazionale Idrocarburi (ENI)
- * Gulf Oil Corporation
- * Mobil Oil Corporation
- Petrofina S.A.
- OMV Aktiengesellschaft
- Petroleum Association of Japan/Petroleum Producers Association of Japan
- Shell International Petroleum Company
- * Standard Oil Company of California
- Statoil
- * Texaco Inc.
- VEBA Oel, A.G.

*U.S. oil companies.

Based on our observations, the major international oil companies, both U.S. and non-U.S. (Exxon, Texaco, Socal, Mobil, British Petroleum, and Shell International) play a lead role in IEA activities, particularly industry advisory activities and meetings, yet we found no evidence that the meetings have been used to generate or support anticompetitive practices. These companies are permanent members of the Industry Advisory Board and tend to occupy the positions of IAB Chairman and IAB Subcommittee Chairman on a fairly regular basis.

The major oil companies devote more staff and money to advisory activities and have a greater company financial interest; the smaller companies will not spend comparable resources, but they have been encouraged to participate more actively in industry advisory group activities. We are aware of no oil company which has expressed concern that the dominance of the majors in these meetings has competitively harmed any other participating company or that the IEA systems that have been developed do not carry out the interests of the smaller companies as well as those of the majors. However, some concern has emerged from the Federal Trade Commission, one of the principal U.S. antitrust monitoring entities, that a way be found to encourage greater public awareness of oil company participation in the IEA System so that the U.S. Government can have the benefit of the views of affected individuals who are not presently part of the International Energy Program (IEP). In an April 18, 1980 letter to the Secretary of Energy, the Chairman of the Federal Trade Commission commented:

> ". . . . For instance, views of small business groups concerning the potential impact of the system on competition would aid the Federal Trade Commission in the preparation of its semi-annual reports. Consequently, I offer you the following proposals which may lead to improved antitrust reporting and greater public awareness of the IEP, without jeopardizing the national security interests or otherwise impairing the functioning of the IEP.
>
> First, DOE should consider establishing an advisory committee of representatives of citizens' groups and smaller petroleum firms or associations that do not participate in IEP activities. Members of this committee should have security clearances to permit them to have access to all meetings' transcripts, as well as to all documents circulated to the members of the IEP advisory groups that do not contain proprietary information. The committee would meet periodically with United States government representatives to be briefed on the IEA system and to provide advice on whether the system may have potential adverse effects

> on competition, on small business, or on the public. Because the committee would include individuals with practical oil industry experience, the committee should be able to provide additional insights into the IEP system and provide a perspective not currently available. Establishing such a committee may improve the quality of the Commission's semi-annual reports and increase public surveillance of oil company involvement in the IEP without unduly interfering with IEP activities."

Although DOE has not instituted such an advisory committee, the Secretary of Energy does have authority under EPCA to do so. We believe the establishment of an advisory committee on IEA matters could, among other things serve to assure broad and balanced participation of both large and small oil companies. The advisory committee would provide a communication vehicle for smaller oil companies, consumers, and other interested parties.

Q. 4. Does Section 251 of EPCA provide sufficient authority for the U.S. to establish a fair sharing system to meet its IEA obligations?

A. 4. In the context of the International Energy Program and its Emergency Sharing System, fair sharing refers to the distribution of available oil among petroleum companies operating within one participating country so that no one petroleum company is disproportionately penalized or benefited due to its authorized actions taken to implement the IEA Emergency Sharing System. Thus, fair sharing is a principle of sharing oil domestically among companies which complements the Emergency Sharing System by taking away a major disincentive from full company participation in the Emergency Sharing System. Fair sharing contrasts with the principal objective of the IEA Emergency Sharing System, which is to allocate oil internationally among participating countries. Fair sharing among oil companies is not a legal requirement of the IEP, but its significance to the effective implementation of the Emergency Sharing System is recognized in the IEA's Emergency Management Manual. The Emergency Management Manual places responsibility for fair sharing or correction of imbalances between companies on the individual member governments out of recognition of the differences among member governments with respect to antitrust laws and competition.

At the time of the enactment of the Energy Policy and Conservation Act (EPCA) and the development of the IEA's Emergency Sharing System, petroleum in the United States was, in large part, subject to the domestic allocation and price restraint provisions of the Emergency Petroleum Allocation Act. Thus a U.S. domestic fair sharing system complementing the IEA Emergency Sharing System was integrated into the EPAA domestic allocation program, and it was not a matter of discussion when EPCA was enacted. Now, however, EPAA has expired along with its implementing domestic allocation program. The issue then is whether any provision of EPCA can legally authorize the development of a fair sharing system, although it may not originally have been intended to do so. Primary attention for that purpose has been directed to section 251 of EPCA.

The relevant portion of section 251 of EPCA, 42 U.S.C. §6271, states:

> "The President may, by rule, require that persons engaged in producing, transporting, refining, distributing, or storing petroleum products, take such

> action as he determined to be necessary for implementation of the obligations of the United States under chapters III and IV of the international energy program _insofar as such obligations relate to the international allocation of petroleum products._ * * *" (Emphasis added.)

Thus section 251 relates specifically to the "international allocation of petroleum," and chapters III and IV of the IEP involve only allocation among _countries_ and not companies.

Nevertheless, on August 10, 1981, the General Counsel of the Department of Energy issued an opinion, which was concurred in by the Assistant Attorney General in charge of the Justice Department's Lands and Natural Resources Division, concluding that section 251 of EPCA can legally support a U.S. domestic fair sharing program by permitting a Presidential finding that it is "necessary" to impose a mandatory limited domestic allocation system in order to secure the swift and sure cooperation of oil companies in fulfilling our international obligations. This position was reaffirmed in Justice's November 25, 1982, "Memorandum of Law of Legal Authorities Available to the President to Respond to a Severe Energy Supply Interruption or Other Substantial Reduction in Available Petroleum Products."

In GAO's March 4, 1983 analysis of Justices's Memorandum (GAO/OGC-83-6), we advised members of the Senate Committee on Energy and Natural Resources that

> " * * * oil industry lawyers have informally advised the Administration that if the Government attempts to implement certain of the energy emergency statutory authorities in the manner in which the Justice Department has construed them in its memorandum, elements in the private sector will institute litigation to enjoin implementation. An example is the Administration's construction of section 251 of EPCA, 42 U.S.C. §6271, so as to permit limited domestic petroleum allocation. Such litigation could impede fulfillment of the obligations of the United States under the International Energy Program. * * * Clarifying legislation now, before an international energy emergency occurs requiring implementation of section 251, might merit consideration."

GAO reaffirmed this position in its March 7, 1983, statement and testimony before the Senate Committee on Energy and Natural Resources on the Nation's preparedness for dealing with energy supply disruptions.

Q. 5) What is the status of the revised Plan of Action being developed by the U.S. Government? Are there any areas of particular concern that need to be addressed?

A. 5) The Department of Energy on May 8, 1981, published in the Federal Register a proposed Plan of Action and requested comments from industry and the public. The proposed Plan of Action will supplement the currently approved Voluntary Agreement and does contain more detail on the types of actions which companies may take legally during an international energy supply emergency. However, rather than finalize the Plan of Action after analyzing the comments received, the Department of Energy decided to wait until AST-4 was over, since experiences there might be useful in refining the Plan of Action. A new draft was circulated among the interested Government agencies on September 23, 1983. If there is general agreement among the U.S. agencies on this draft, it is expected that this revised draft Plan of Action will be published in the Federal Register for further comment in the near future. Any Plan of Action is subject to approval by the Departments of Energy and Justice after consultation with the Federal Trade Commission. The Plan of Action would then be open to interested reporting companies for signature. The Plan of Action would go into effect only if the President makes a finding that an international energy supply emergency exists.

There were two areas of some concern regarding the revised Plan of Action: (1) whether type 1 transactions should be accorded antitrust protection, and (2) whether the Industry Supply Advisory Group (ISAG) should receive pricing data from the reporting companies in the course of receiving voluntary offers.

There are 3 types of transactions recognized in the IEA Emergency Sharing System. Type 1 transactions are those ordinary commercial actions taken by companies during an emergency without involvement of the IEA or member governments. Type 2 transactions are those associated with the making of voluntary offers to the IEA system to supply or receive oil. These transactions involve the ISAG. Type 3 transactions are those mandated by member governments at the request of the IEA.

Up to this point, only type 2 and 3 transactions have received antitrust protection. However, during the development of the proposed Plan of Action, serious consideration was given to the possibility and consequences of extending the antitrust defense to type 1 transactions. We were concerned whether the Department of

Justice and the FTC would have adequate manpower and resources to undertake this significantly larger antitrust monitoring responsibility, due to the large number of type 1 transactions, the difficult problem of developing satisfactory recordkeeping requirements, and the associated problem of overseeing the substantially larger number of records. If the monitoring was not adequate, the anticompetitive risks could be substantial.

In the September 23, 1983, DOE draft Type 1 transactions are not covered by the antitrust defense. Therefore, our concern about this element of the proposed Plan of Action has currently been favorably resolved. Of course, there is no assurance that the Department of Energy's position will not be modified before the Plan of Action is finalized and signed by those companies agreeing to its terms.

The second issue of concern was whether the ISAG in the regular course of attempting to match voluntary offers should have access to the oil pricing elements that companies would be considering as part of the voluntary offers that they make to the IEA system. The ISAG is, of course, composed of company representativesskilled in petroleum supply, marine transportation of oil, etc., who directly receive the voluntary offers from reporting companies. The ISAG's responsibility is to evaluate the incoming voluntary offers in light of their expertise and the nature of the oil emergency, and to recommend to the IEA Allocation Coordinator (Executive Director of the IEA) matches of voluntary offers to supply oil with voluntary offers to receive oil in an attempt to balance allocation rights and obligations of member countries. The decision to approve a recommended match is made by the IEA Allocation Coordinator, sometimes in conjunction with representatives of all of the participating countries. The ultimate decision in each case is made by a government official and not industry.

Some thought that the resources and time of the ISAG could be more efficiently used if company pricing information were included with their voluntary offers. If there were a wide disparity between the prices that a prospective supplier was demanding and the prices that a prospective buyer was willing to pay, it may be foolhardy or a waste of time to recommend this prospective seller and this prospective buyer as a match. However, we were concerned about the antitrust risks associated with providing members of the ISAG with pricing information of each of the companies making voluntary offers.

In the draft Plan of Action circulated among the agencies of the U.S. Government on September 23, such pricing information to the ISAG was not included within actions which would have antitrust protection, thereby reducing our concern. Of course, this position is also subject to change during the finalization of the Plan of Action.

Q. 6) Does the IEA continue to limit the terms of Secretariat employees to 3 to 5 years?

A. 6) Yes, the IEA remains firmly committed to this personnel policy. The basis for this policy remains as described in our September 8, 1981 report, "Unresolved Issues Remain Concerning U.S. Participation In the International Energy Agency" (ID-81-38):

> "Its [IEA's] personnel and administrative practices generally follow those of OECD, although there are some important distinctions; for example, Secretariat employees, except for the Executive Director and some high-ranking staff and some technicians, have only 3 to 5-year contracts. Unlike OECD, the Secretariat expects a turnover in staff to ensure fresh thought and dynamic action as well as to prevent the establishment of an entrenched bureaucracy. The Executive Director told us that the IEA suffers no loss of expertise because of the 3 to 5-year policy. Nevertheless, this policy could prevent organizational continuity at many of the important professional technical levels involving emergency sharing, oil market information systems, long-term cooperation, research and development, and producer-consumer dialogs. The Secretariat maintains that a sufficiently trained staff is always present and that in an emergency this staff would be assisted by experts drawn temporarily from governments and industry. The Department of State noted that it had not detected any serious lack of expertise or continuity resulting from this policy."

Q. 7. What is the status of GAO's overall follow-up report on U.S. participation in the IEA that I have requested?

A. 7. We are in the process of drafting the overall report and hope to issue it sometime during the first quarter of 1984. This report, when issued, will be the completion of a series of reports you requested in September 1982. As of this date we have issued the following reports on specific areas of U.S. participation in the IEA.

A. "Determination of Oil Price In the International Emergency Sharing System," GAO/ID-83-15, 11/12/82.

B. "Information On The Operation Of The International Energy Agency's Coal Industry Advisory Board," GAO/ID-83-44, 4/21/83.

C. "Assessment Of U.S. Participation In The International Energy Agency's Fourth test Of Its Emergency Sharing Allocation System," GAO/NSIAD-84-4, 10/13/83.

Q. 8) How extensive is current Justice and FTC antitrust monitoring of U.S. oil company involvement in the IEA?

A. 8) The Department of Justice and the FTC have extensive antitrust monitoring responsibilities associated with U.S. oil company involvement with the IEA. The statutory antitrust safeguards in section 252 of the Energy Policy and Conservation Act (EPCA) both require and facilitate this monitoring. Some of these statutory requirements are duties directly placed on Justice and the FTC, while others are administered by the Department of Energy, as the administrator of the Voluntary Agreement; nevertheless, they all tend to facilitate antitrust monitoring by Justice and FTC. The statutory antitrust safeguards in EPCA include:

1. Industry advisory meetings must be preceded by timely and adequate advance notice in the Federal Register with identification of the agenda.

2. No meetings may be held unless a regular full-time Federal employee is present.

3. A full and complete record, and where practicable a verbatim transcript, must be kept of any meeting held.

4. A full and complete record must be kept of any communications made, between or among participants or potential participants, to develop or carry out a voluntary agreement or plan of action.

5. The transcript or record must be deposited with the Department of Energy and shall be available to the Attorney General and the Federal Trade Commission.

6. Records or transcripts are available to the public, subject to withholding of portions necessary to protect the defense or foreign policy of the United States or trade secrets.

7. Representatives of committees of Congress may attend meetings and have access to any transcripts, records, and agreements kept or made.

8. The Attorney General and the Federal Trade Commission are directed to participate from the beginning in the development of the voluntary agreement, and to propose alternatives which would avoid or overcome, to the greatest extent practicable, possible anticompetitive effects while achieving substantially the purposes of the International Energy Program.

9. A voluntary agreement or plan of action may not be carried out unless approved by the Attorney General after consultation with the Federal Trade Commission.

10. The Attorney General shall have the right to review, amend, modify, disapprove, or revoke, on his own motion or upon request of the Federal Trade Commission or any interested person, any voluntary agreement or plan of action at any time, and, if revoked, thereby withdraw prospectively any immunity which may be conferred by subsection (f) or (k) of section 252 of the Act.

11. Any voluntary agreement or plan of action shall be available for public inspection and copying, subject to classification exceptions.

12. Any action taken pursuant to a voluntary agreement or plan of action shall be reported to the Attorney General and the Federal Trade Commission pursuant to their regulations.

13. A plan of action may not be approved by the Attorney General unless such plan (A) describes the types of substantive actions which may be taken under the plan, and (B) is as specific in its description of proposed substantive actions as is reasonable in light of known circumstances.

14. The Attorney General and the Federal Trade Commission shall monitor the developing and carrying out of voluntary agreements and plans of action in order to promote competition and to prevent anticompetitive practices and effects, while achieving substantially the purposes of the Act.

15. The Attorney General shall promulgate rules concerning the maintenance of necessary and appropriate records related to the development and carrying out of voluntary agreements and plans of action.

16. Persons developing or carrying out voluntary agreements and plans of action shall maintain these records, to which the Attorney General and the Federal Trade Commission shall have access and the right to copy at reasonable times and upon reasonable notice.

17. An antitrust defense is available to a person in any antitrust civil or criminal action only if

(A) such actions were taken--

(1) in the course of developing a voluntary agreement or plan of action, or

(2) to carry out an authorized and approved voluntary agreement or plan of action and

(B) such person complied with the requirements and rules under section 252 of the Act.

18. The statutory antitrust defense is not available if the actions were taken for the purpose of injuring competition.

19. Persons interposing the statutory antitrust defense have the burden of proof and must demonstrate that the actions were specified in, or within the reasonable contemplation of, an approved plan of action, except that the burden shall be on the person against whom the defense is asserted with respect to whether the actions were taken for the purpose of injuring competition.

20. The Attorney General and the Federal Trade Commission must each submit to the Congress and to the President, at least once every six months, a report on the impact on competition and on small business of actions authorized by section 252 of the Act.

21. The U.S. Government may not submit to the International Energy Agency company proprietary or confidential information in a disaggregated form, such that the supplying entity could be identified, unless the President, after hearing, certifies that the IEA has adopted and is implementing security measures which assure that such information will not be disclosed by the IEA or its employees to any person or foreign country without having been aggregated, accumulated, or otherwise reported in such manner as to avoid identification of any entity from whom the United States obtained the information or data.

22. If the President determines that the transmittal of certain data or information to the IEA would prejudice competition, violate the antitrust laws, or be inconsistent with United States national security interests, he may require that the data or information not be transmitted.

In addition to these statutory antitrust provisions, an advance clearance has been established in the Voluntary Agreement governing the circumstances under which company proprietary or confidential information may be discussed during industry meetings. The clearance may be granted by the Department of Energy, after consultation with the Department of State, and with the concurrence of the Department of Justice, after consultation with FTC. Specific limitations have been carefully prescribed in each instance in the clearance document. The procedure has been used in association with imminent crises, such as the Iran/Iraq War, as well as in the testing of the IEA Emergency Sharing System, including AST-4. For purposes of the Voluntary Agreement, the circumstances of a test are considered one industry meeting.

GAO has no reason to believe that the antitrust monitoring by Justice and the FTC has not been effective in preventing anticompetitive conduct associated with U.S. oil company participation in IEA activities. Moreover, both agencies have reported in their semiannual reports to the President and Congress that they have found no anticompetitive consequences from such participation. We have found these Justice and FTC reports very helpful in analyzing and summarizing industry participation in IEA activities.

Q. 9. What is the status of the U.S. Government's response to weaknesses identified in U.S. participation in AST-4?

A. 9. At a September 14, 1983 IEA post-test assessment meeting, the United States agreed to a review of its emergency preparedness program by the IEA to determine to what extent it fulfills the U.S. obligation under the IEP. As of this date, the IEA assessment team has not been formed, and no date has been set for the review.

On September 22, 1983, the Assistant DOE Secretary responsible for AST-4 follow-up, made the following statement for the record:

> "Following the completion of AST-4, the DOE prepared and recently submitted to the IEA its evaluation of the exercise. We noted in the report a number of issues (e.g., data and procedural) that warrant further analysis. In this connection, the U.S. has supported the establishment of an ad hoc technical working group in the IEA to review these issues. The U.S. has also supported a review of IEA country emergency programs to further assess changes in national approaches to demand restraint and fair sharing, including the impact of different internal prices (i.e., price controls). The U.S. continues to support revision of the IEA Emergency Management Manual to eliminate the outdated reference to "term" pricing, a key recommendation in the IEA Group of Experts appraisal report on AST-4, as the current language could inhibit effective operation of the voluntary offer system in an actual emergency. Finally, the DOE has begun revising internal operating manuals to reflect lessons learned in the AST-4 exercise, and these will be further revised upon establishment of any new procedures in the IEA in connection with the initiatives previously noted."

Statement of Charles J. DiBona
President - American Petroleum Institute
before the
Committee on Energy and Natural Resources
United States Senate
October 19, 1983

Thank you, Mr. Chairman, for the opportunity to appear before you on the important issue of emergency preparedness. My name is Charles DiBona. I am the President of the American Petroleum Institute, which represents some 300 petroleum companies and about 6,500 individual members who are engaged in all aspects of petroleum exploration, production, transportation, refining and marketing.

In my appearance before this Committee in June 1981 on emergency preparedness policy, I tried to convey three relatively simple and closely related points:

- Any supply disruption will cause some inconvenience and economic loss to the nation as a whole.
- Relying on the market to the maximum extent possible during a disruption will provide the most efficient distribution of the limited supplies available and thus will minimize the nation's economic losses.
- Experience with the government price and allocation controls during disruptions in the 1970's has clearly demonstrated that such controls only exacerbate the effects of the supply disruption and increase the costs imposed on the nation.

These points are still valid today. Indeed, their validity has been confirmed by the positive effects we have seen from reliance on markets. Since the decontrol of crude oil and petroleum products in early 1981, the domestic oil production outlook has improved considerably. Important gains have been made in conservation. Fuel-switching has also made a significant contribution to increasing the nation's flexibility in meeting its energy needs. U.S. oil imports have decreased dramatically, representing only 32% of total domestic supply for the first 9 months of 1983, compared with 43% for the corresponding period of 1978.

The bill which is the subject of today's hearing, S. 1678, recognizes the importance of minimizing government interference in the market. It carefully avoids establishing any statutory authority for the type of price and allocation controls which exacerbated the effects of previous supply disruptions. Before discussing several specific provisions of S. 1678, I would like to take a few minutes to explain the importance of relying on market forces during any future supply disruptions.

If reliance on market forces is important under normal conditions, it is even more crucial during a disruption in order to ensure that the limited supplies available are used most efficiently. In addition, it is vitally important that production be maximized and that fuel-switching and conservation also help in adjusting to the disruption. In past disruptions, price controls gave the wrong signals--encouraging consumption at a time when conservation was most needed and discouraging fuel-switching and additional production.

Much of the recent discussion of emergency preparedness programs has concentrated on highly speculative projections of high petroleum prices during large and protracted supply disruptions and on the potential economic losses. There has been an implication in some of these discussions that the high prices could be avoided if the government imposed price controls. This view confuses cause and effect. It fails to recognize that any large-scale disruption will impose economic hardships. These hardships result from the physical shortage of a vital commodity--crude oil. Severe supply disruptions always impose costs on consumers no matter whether these costs are highly visible, as in higher prices for petroleum products, or perhaps less obvious (but not necessarily less costly) as in long gasoline lines. Government controls would simply exacerbate the impact of the disruption.

There is no way to entirely avoid the economic losses in terms of fewer jobs and reduced GNP--the task is to minimize them. During any future supply disruptions, consumers will benefit most if the market is relied on as much as possible. Market forces distribute supplies most efficiently, and in the long run, can actually hold prices below what they would be under government controls.

If supplies become scarcer, the market will immediately recognize the change and begin to adjust. Prices will rise at the outset as supplies become less plentiful. These early price increases will encourage more conservation, stimulate greater domestic energy production and encourage greater fuel substitution. This will help soften the impact of the disruption as quickly and as efficiently as possible.

Prices would rise initially under a market approach--as they rose eventually under controls. But the long-term price impact of the disruption will not be nearly as great if prices are held in check by market forces rather than by government intervention in the market. The more government intervenes and prevents the market from operating, the greater will be the cost to the public. Government price and allocation controls will not only cause inconvenience, but will also result in real losses to the public in such forms as increased unemployment, scarcer and more costly food, school closings, etc. There is no dispute among economists that price controls cause a greater reduction in the goods and services available to the nation than reliance on the market would.

From the nation's experience during the past decade, it is clear that there is one policy for coping with supply disruptions that will not work--the imposition of price and allocation controls. It was used twice--by two different Presidents sincerely trying to ease the pain of modest supply shortfalls--and each time it failed. It succeeded in creating two troublesome crises of major dimensions from relatively small import losses. Even the government's own analyses concluded that price and allocation controls made the situation worse. (See Department of Justice and DOE studies of the 1979 Iranian disruption.) If used again, under this or any Administration, controls will again make the problem worse.

Much can be said about the specific problems caused by controls. These problems are described in greater detail in a study done under a grant from the American Petroleum Institute by William C. Lane Jr., "The Mandatory Petroleum Price and Allocation Regulations: A History and Analysis."

In summary, government controls did not protect Americans from higher oil prices--rather, they resulted in a lower standard of living and higher unemployment. There is considerable evidence that the price controls, by keeping U.S. prices down at the outset of each disruption, actually stimulated U.S. consumption, enabling foreign producers to raise their prices substantially during the crisis. These price hikes transferred much more wealth from U.S. consumers to foreign producers than would have otherwise been the case.

In fact, the threat of such controls can provide a powerful disincentive to preparing for future disruptions. For example, authority for such controls would tend to discourage the building of private stocks. It would also lessen the incentives to invest in fuel-switching capabilities.

Thus, it is important that we not repeat the mistakes of the past. S. 1678 avoids those mistakes because it does not create any statutory authority for price and allocation controls. Instead, it contains several provisions which are necessary to minimize interference by the government in the market. In particular, S. 1678 contains provisions to address two problem areas which otherwise could damage the country's ability to deal with a future energy supply crisis. If enacted, these provisions would enable industry to work more effectively with government in minimizing the adverse impact of any supply interruption and would guard against counterproductive action by other levels of government.

The API believes that to facilitate the planning for and response to a possible supply disruption, a process should be developed for federal government and private sector consultation and cooperation. Advisory committees, the National Defense Executive Reserve units, voluntary agreements and plans of action are just a few of the means for such consultation and cooperation.

No matter what organizational structure is adopted, industry can provide valuable insights into the nature, magnitude and duration of a disruption to assist the government in developing an appropriate response. This type of input is of particular importance because the appropriate government response to any supply disruption cannot be determined in advance. Rather, it will depend on the particular circumstances prevailing at the time.

Industry advice and expertise has proved valuable in the past. Although largely precluded from doing so at the time of the 1973-74 oil embargo, oil company personnel served in many U.S. government agencies and on government-sponsored committees in earlier emergencies. Their record of performance clearly demonstrates that industry expertise can be helpful in responding to an energy emergency. Indeed, there is reason to believe that government access to industry expertise is probably essential for a successful response.

During both World Wars and the Korean War, special government agencies were established to deal with oil supply problems. These agencies were assisted by industry advisory committees. The advisory committees helped in achieving the government's principal objectives, which were to increase domestic supply, ensure adequate production of specialty fuels and facilitate the efficient movement of fuels to their destinations.

People in the petroleum industry are anxious to be of help in the future as they have been in the past. We believe we can make a unique contribution during emergencies. Responsibility for government action during a crisis must lie with the government. But people in our industry stand ready to provide help and insight whenever the government seeks our assistance.

If such industry/government groups are to be of assistance in the assessment of the disruption, they may be called upon to discuss sensitive competitive information. Moreover, members of such groups may be subject to government requests that companies take voluntary actions to mitigate or avert potential problems. Current law provides an antitrust defense for cooperative activities covered by a voluntary agreement which complies with the Energy Policy and Conservation Act (EPCA) or with the Defense Production Act (DPA). Under EPCA, a voluntary agreement can be implemented only for activities associated with U.S. obligations under the International Energy Program. Without new legislation, the DPA must be invoked to protect any other cooperative activities. However, the DPA requires some nexus to national defense preparedness. It is questionable whether such a nexus could be established in supply disruptions which would not require a full-scale mobilization effort.

Without appropriate antitrust protection, members of the industry will be understandably reluctant to participate in any such groups. S. 1678 seeks to facilitate industry involvement by exempting industry employees (but not employers)serving in the Executive Reserve units or under a voluntary agreement from certain federal antitrust restrictions, if the President finds that the national interest requires such action. However, S. 1678 does not recognize that similar problems may be posed by state antitrust statutes.

In assessing and responding to a supply disruption, the government might also wish to have some industry personnel with particular expertise serve within the government to evaluate problems, propose solutions, appraise the impact of any such government intervention, etc.

During some previous emergencies, the government was able to recruit and employ industry personnel on a temporary basis to assist in managing energy emergencies. Current federal conflict-of-interest statutes severely limit the involvement of industry personnel as full-time government employees. Besides onerous financial disclosure requirements, these restrictions could create impossible financial hardships for an employee and almost preclude any possibility of the employee's returning to his or her company after government service.

If industry expertise in an energy emergency is to be readily available on a day-to-day basis, the conflict-of-interest laws must be amended. S. 1678 contains many of the necessary amendments to minimize the obstacles posed by the conflict-of-interest statutes. However, it does not address the financial disclosure issue.

State price and allocation programs also are of great concern. Although this Administration is committed to avoiding interference by the federal government in the market, numerous state emergency statutes have been enacted which could undermine the market's ability to adjust to changing circumstances. More than 40 states have adopted emergency energy statutes. While some state programs may address valid local concerns, those programs which would regulate the price and allocation of crude oil and petroleum products are clearly counterproductive and not in the national interest.

It is conceivable and, some would argue, likely that as many as 50 separate and unique state allocation programs, at cross purposes with federal policy and with each other, could be implemented during any future supply disruption. Such programs would significantly limit the market's ability to allocate supplies efficiently and thus would be in direct conflict with the national interest and the Administration's stated preference for relying on markets to the maximum extent possible. In fact, these state programs would severely limit the President's flexibility in tailoring his response to a given disruption. If implemented during a small shortfall or very early during any disruption, state programs could force the federal government to intervene when it would be wiser for it not to do so.

Furthermore, the collective interest of all the states would suffer from implementing the proliferation of laws establishing emergency programs at the state level. Although our energy problems are clearly national problems, state laws could be designed to shift to other states the effects of those problems, rather than to solve them in the interest of the entire nation. Such action, while appearing on the surface to benefit the citizens of a given state, would necessarily act to the detriment of citizens in other states, who, in turn, would be prompted to take similar action. Thus, in the long run, all would suffer.

Consequently, state efforts to reimpose the type of controls that the federal government has abandoned would undermine national policy and be detrimental to the collective interests of the states. S. 1678 recognizes the problem posed by such state laws and provides appropriate preemption of these programs.

Federal preemption of state price and allocation programs and removal of the obstacles to industry-government consultation and cooperation posed by the antitrust and conflict-of-interest statutes are necessary to minimize interference with market mechanisms. As noted earlier, reliance on the market to the maximum extent possible will ensure that the limited supplies available during a disruption are distributed in the most efficient manner.

However, reliance on markets does not mean that there is no role for the government to play during a disruption. But government actions during an emergency should be tailored to the specific conditions prevailing during the disruption. Therefore, a process for developing a flexible approach to deal with disruptions should be established, rather than rigid plans. In the event of a severe supply disruption, some form of government intervention may be appropriate, but previous disruptions have demonstrated that price and allocation controls are not the solution. One important tool available to the government for responding to energy emergencies is the Strategic Petroleum Reserve. A temporary change in environmental regulations to facilitate greater fuel-switching is yet another example of how the government can enhance energy supplies during a disruption.

This concludes my statement, Mr. Chairman. I appreciate the opportunity to appear before this committee and welcome any questions on the issues covered in my testimony.

National Council of Farmer Cooperatives
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Before the
Committee on Energy and Natural Resources

U.S. Senate

HEARING ON S. 1678:
ENERGY EMERGENCY PREPAREDNESS ACT AMENDMENTS OF 1983

Statement of
R. Thomas Van Arsdall
Vice President, Agricultural Inputs and Services

October 19, 1983

Statement of
R. Thomas Van Arsdall
Vice President, Agricultural Inputs and Services

Mr. Chairman and Members of the Committee:

My name is R. Thomas Van Arsdall, and I am Vice President of Agricultural Inputs and Services with the National Council of Farmer Cooperatives. The National Council is pleased to have the opportunity to appear and testify before this Committee on the Energy Emergency Preparedness Act Amendments of 1983 (S. 1678).

The National Council of Farmer Cooperatives is a nationwide association of cooperative businesses which are owned and controlled by farmers. Its membership includes 109 marketing and farm supply cooperatives, the 37 banks of the cooperative Farm Credit System, and 32 state councils of farmer cooperatives. National Council members handle practically every type of agricultural commodity produced in the United States, market these commodities domestically and around the world, and furnish production supplies and credit to their farmer members and patrons. Two-thirds of United States farmers are affiliated with one or more cooperatives. The National Council represents about 90 percent of the more than 6,400 farmer cooperatives in the nation, with a combined membership of nearly 2 million farmers.

Among the farmer cooperatives the National Council represents are supply cooperatives which own and operate five efficient refineries possessing an aggregate production capacity of 301,000 barrels per day, and whose yields of gasoline, diesel fuel and heating oil amount to approximately 85 to 90 percent of their refined products. While this represents less than two percent of United States refining capacity, cooperatives market petroleum products in more than 40 states and currently supply about 45 percent of all on-farm fuel and a large portion of rural needs.

Farmer cooperative petroleum operations represent the only segment of the oil industry in which the consumers of its products are also its owners. This feature carries with it a unique accountability in terms of commitment of supply, service and price.

In brief, this statement focuses upon the critical need for legislative action to require major improvements in SPR drawdown policy as the key to developing effective contingency capabilities. (1) Policies should attempt to minimize shortages, economic damage and government intrusion; (2) Behavior under the uncertainties and stresses of an oil crisis precludes the "free market" from operating normally; (3) S. 1678 should be reported favorably, with appropriate modifications; (4) The SPR should be used early in a disruption, and distributed to domestic refineries, as the most efficient means of meeting national and economic security objectives; and (6) A carefully designed state preemption, with provision for state set-aside, and other modifications, should be used to complement SPR drawdown policy.

Attachment A, "The Need for an Effective Drawdown Plan for the Strategic Petroleum Reserve," elaborates further on the National Council's concerns regarding the present drawdown plan, and recommended revisions.

I. EMERGENCY PREPAREDNESS POLICY MUST COMPLEMENT BROADER NATIONAL OBJECTIVES

When considering SPR policy and related emergency preparedness alternatives, the National Council believes that three essential objectives should be kept in mind:

- Minimize and eliminate where possible the adverse effects of regional and national shortages, with a priority on maintaining essential services.
- Minimize severe damage to the national economy caused by the ratchet effect of permanent, disruption-driven energy price increases.
- Minimize the effect of government intrusion through timely and effective response.

The National Council has consistently endorsed decontrol of the domestic petroleum industry during normal market periods. Indeed, to the extent that the marketplace can deal adequately with a disruption, government should not interfere. However, to the extent that the market exhibits signs of breaking down, either in the form of uncorrected regional shortages or rapid price escalations, effective emergency preparedness response procedures must be readily available, and implemented in a timely manner.

The real potential of a future disruption represents a direct threat to this nation's national and economic security. History has demonstrated that if inventories are tight, even a relatively minor disruption can cause serious regional shortages and can more than double petroleum prices permanently. Consumers and the economy are big losers, not the oil industry.

Emergency preparedness policy has evolved to the point where the SPR represents the only significant line of defense which can be used effectively to meet national and economic security objectives. The SPR can reach its potential only if it is filled to adequate levels, and a responsive drawdown plan is developed. The major and overriding advantage of the SPR is that additional supplies can be injected into the system to offset shortages and sharply ease uncertainties.

II. OIL PRICES: BEHAVIOR UNDER UNCERTAINTY

Free Market Allocation Fails in Practice During Disruption:

The philosophical basis for "free market" allocation and pricing of petroleum during a disruption presumably is that (1) the shortage will generate price increases; (2) those who require fuel most will therefore bid the most, with supply moving to areas of need; (3) those of lesser need will drop out of the bidding, thereby bringing demand into balance with supply; and (4) prices will return to "normal" levels once the disruption has ended. The National Council must cite several significant concerns regarding the operation of these postulates in the real world, during a shortage:

- The ability to pay does not match up with need.
- Shortages are not uniform on a regional basis.
- The altered decision equation restricts normal sales behavior and results in inventory buildup at the worst possible time.
- Prices which result do not return to previous levels, but tend to become semi-permanent economic burdens.
- Congress and the Administration undoubtedly would be subjected to overwhelming political pressure to intervene in the marketplace if prices rise significantly or if shortages persist.

AST-4 Test Illustrates "Laissez-Faire" Flaws:

The National Council's concern about total reliance upon market forces during a disruption is dramatically highlighted by the recent AST-4 simulation test. The DOE's economic impact analysis estimated that crude oil prices would have more than tripled during a world petroleum supply interruption of eight million barrels per day in the spring of 1981, with massive adverse macro-economic impacts.

In spite of these crisis-level developments, the assumption cited in the analysis merely reaffirmed the Administration's policy to withhold general use of emergency authorities, relying instead exclusively upon market mechanisms in the form of sharply higher oil prices to adjust demand and supply to a new equilibrium. At this advanced stage in the simulated disruption, there was still no decision to draw down the SPR!

The AST-4 exercise was called a success by the DOE, in terms of U.S. oil companies voluntarily selling crude oil to the international market in quantities sufficient to meet U.S. oil-sharing obligations. Indeed, this assertion was carried one step further when Assistant Secretary Vaughan declared in a letter to one of the National Council's members that examination of oil company data and test messages indicated that "...oil products were available on an as-needed basis for farmers and all consumers through the numerous suppliers of oil to the U.S. market."

This claim--in light of a shortage of the magnitude indicated, and exacerbated by diversions of crude oil from the U.S. to overseas markets--defies our understanding of the real world. The analysis clearly fails to consider the shortage mentality, confusion and economic suffering generated by the breakdown of normal market forces. Agriculture's own bitter experience at the end of the petroleum distribution system is that even minor disruptions can cause critical shortages and sharp price increases.

The National Council regards a "laissez-faire" approach under such circumstances as unacceptable. The consumer and the U.S. economy end up as big losers. And the Congress is placed in the untenable position of facing constituency demands to "fix it" in the midst of crisis.

Decision Equation Radically Altered During Shortages:

In searching for the most appropriate and effective use of the SPR during a crisis, it is vitally important that the altered decision-making behavior of individuals who comprise the petroleum industry and the user community, when placed under the uncertainties and stresses of an oil shortage, be understood. If inventories are tight, a shortage can occur in the United States as soon as the event overseas hits the front page. Both the petroleum industry and end users attempt to stretch out existing supplies and rebuild low inventories in anticipation of a potentially larger or longer shortage.

Those who lose their supplies or find themselves short in this environment find it extremely difficult, if not impossible, to purchase additional supplies, regardless of their ability to pay. In normal times, the offer of a premium might generate a corporate decision to sell outside one's own system. During a shortage, a number of significant forces radically alter the equation:

- Oil companies are, for obvious reasons, dedicated to protecting their own distribution systems and markets in the face of a shortage of unknown duration.
- These companies will also cancel off-system sales where possible, and even increase purchases in the spot market.
- In addition, they tend to place their jobbers and retail outlets on allocation fractions during tight supplies, both to distribute short-falls equitably and for legal reasons.
- In some instances, inventories already on hand may be held for speculative purposes.

Of course, all of these actions combine to withhold petroleum from the market and exacerbate or even create shortages and rigidities within the system.

Private inventories in the petroleum and user communities are frequently cited as a major element of emergency response procedures. It is important to recognize the inescapable reality that management of petroleum inventories in the private sector runs counter to emergency preparedness objectives. Inventories are drawn down to minimum levels between disruptions, for short-run economic reasons. Attempts are made to rebuild inventories at the worst possible time, at the onset of a disruption. Presently, inventories of both the petroleum industry and the consuming sector are at minimum levels. We cannot count on private sector inventories to compensate for future disruptions.

An emergency preparedness program can be successful only if it breaks these cyclically self-destructive patterns. By offsetting shortages and reducing the uncertainties and panic mentality which drive both individual and corporate decisions, the SPR tool holds much of the answer.

III. NEEDED: AN EFFECTIVE SPR POLICY

The Congress carefully crafted EEPA around sound national objectives. Unfortunately, inappropriate application of the "free market" philosophy to emergency conditions by the DOE has yielded potentially disastrous contingency plans. In particular, the present SPR Drawdown Plan would largely preclude use of the SPR as a means of offsetting shortages or mitigating disruption-driven price increases.

The National Council is pleased that the Chairman recognizes the need for improvements in contingency planning, and has initiated action to correct some of the deficiencies by introducing S. 1678, and soliciting public comments for this hearing. We have analyzed provisions in S. 1678, and urge that the Committee incorporate appropriate modifications and report this bill favorably.

SPR Must be Filled Aggressively:

The current Administration is to be commended for having worked with the Congress to fill the SPR at an unprecedented rate during its first two years in office. Oil reserves have jumped from less than 100 million barrels in place to approximately 360 million barrels presently. For the first time, the SPR exists as more than just a "last-ditch" military reserve. Substantial volumes are now available for offsetting shortages to varying degrees. As the SPR moves toward the ultimate goal of 750 million barrels, the flexibility to use the SPR in dealing with oil emergencies will expand dramatically.

The National Council has long supported aggressive buildup of the SPR, with suitable qualities of crude oil. We heartily endorse Sec. 4(a) of EEPA, which represents a delicate compromise painstakingly reached between Congress and the Administration. This section sets the minimum fill rate at 300,000 barrels per day, which can be dropped to 220,000 barrels per day if a finding is made by the President that the lower fill rate is consistent with the national interest. This requirement should be reaffirmed, and not lowered as proposed in S. 1678.

The National Council must express its disappointment regarding events which have led to a major erosion in the commitment to fill the SPR during the past year. Sharp restrictions were imposed by the Administration on SPR funding in the FY 84 Interior Appropriations bill (H.R. 3363). Accordingly, the National Council recommends the following fill rate actions:

- Assure that the actual fill rate for FY 84 is at least 186,000 barrels per day.
- Restore funding sufficient to fill the SPR at a minimum of 220,000 barrels per day, as required by EEPA, for FY 85 and beyond.

Given the massive adverse impacts which can be generated by a disruption, there is no better buy than a national SPR insurance program. Contemporary events in the Middle East and in other world hot spots serve as grim reminders that the flow of oil to the United States could be constricted at any time.

SPR Should be Used Early:

When the SPR is used is critical to its effectiveness. There is too little information available to the Congress and to the public to make any determination on what the policy is. The scant evidence which is available, such as the AST-4 Test, strongly indicates that the policy would be to hold off use for as long as possible. In addition, we are concerned that too little oil would be made available, unnecessarily compounding adverse impacts. If these concerns are realized, then much of the potential effectiveness of the SPR will have been negated.

Therefore, the National Council recommends that S. 1678 be amended to incorporate provisions which would require the following:

- Timely and effective utilization of sufficient quantities of SPR crude oil should be established as a response mechanism, early in the disruption.

- Spot market prices, during a disruption, should be used as a lead indicator in the decision to trigger SPR drawdown. This warning signal reflects a composite of basic factors. A study should be initiated now to determine the most appropriate early warning device.

- Provide for greater and more serious cooperation with other consuming nations, as in the IEA. It will take concerted action in terms of strategic reserve drawdown if dangerous price increases are to be minimized. We cannot do it alone.

SPR Should be Distributed to Domestic Refineries at "Normal" Market Prices:

In determining how the SPR oil would be injected into the system once drawdown does occur, the current approach serves to add to uncertainty, and generates unnecessary inflation. SPR oil would be auctioned to a total universe of buyers, with awards made to the highest bidders, regardless of nationality or affiliation. It is quite likely that the U.S. would become a "price leader" in the most undesirable sense, sending signals to the price hawks in OPEC and elsewhere. Distribution on the basis of need is treated only as a "last resort" option, with up to 10 percent of the SPR sales volume available.

The National Council recommends the following amendments to S. 1678 regarding SPR drawdown procedures:

- Distribution of SPR crude oil of suitable quality should be made only to domestic refineries in operation at the time of the disruption. Distribution should focus on refiners who have lost supplies as a result of the interruption.

- All SPR crude oil should be sold at predetermined market price, with appropriate adjustments for crude quality. The price should be reflective of the total market, and not panic conditions embodied in incremental oil prices during the crisis.

- Price levels and distribution procedures should be consistent with the national objectives as stated in EEPA and EPCA.

- Prohibit hoarding or resale of SPR oil (S. 1678 addresses). Purchasers of SPR oil should be required to refine crude oil and inject refined product into the marketplace in a timely manner. Exchanges should be permitted, to the extent necessary to facilitate logistics of moving crude oil.

- Require an actual drawdown and distribution test (S. 1678 permits).

IV. OTHER CONTINGENCY PLANNING IMPROVEMENTS COMPLEMENT CENTRAL SPR TOOL

State Preemption and Set-Aside:

The National Council recommends the preemption of inconsistent state laws, but only if this component complements fundamental changes in SPR drawdown policy. The

Federal Government must be prepared to act in a responsive and responsible manner if alternatives available to states are to be limited. Any preemption should be sensitive to the role and rights of states during emergencies.

Sec. 275(b) of S. 1678 provides parameters for state set-aside authorities. Specific provision should be made for a uniform state set-aside, covering up to five percent of refined petroleum products. States can address local shortages not already corrected by SPR drawdown.

The Committee may want to consider the state preemption and set-aside provisions which were incorporated in S. 1503 during the last session of Congress. That language was adopted as a carefully developed compromise after extended debate.

S. 1678 also attempts to protect private inventories under state set-aside actions. The National Council must question the measure which prohibits taking into consideration the existence or the size of consumer petroleum inventories in determining the amount of petroleum product to be allocated to any such consumer. This would appear to mean that an end user with full storage tanks must be allocated supplies on the same basis as one without any supplies. We believe that this would defeat the purpose of a state set-aside program.

Advisory Board:

Sec. 3 of S. 1678 provides for utilization of industry personnel to advise Administration staff during an emergency. Industry expertise could be used effectively. However, the Federal Government must retain control of the decision process, and not turn the program over to the oil industry.

The National Council believes that an Advisory Board to be comprised of high-level representatives from a cross section of the oil industry and the user community should be created. This Board could advise the Secretary of Energy and the President, evaluate marketplace behavior and make recommendations with respect to SPR drawdown.

Antitrust Exemption:

Antitrust release with regard to voluntary agreements and the energy emergency executive reserves represents a mixed blessing. Certainly, it is required to the extent necessary for industry experts to contribute needed information, and for oil companies to participate in the IEA.

However, of particular concern is the antitrust immunity which applies to abrogation of contracts to meet IEA obligations or to carry out voluntary programs. The National Council must strongly object to this provision as presently structured. The disruption could be exacerbated if contracts for crude oil and/or petroleum products to critical sectors or regions were abrogated under these provisions.

Exports:

The National Council opposes provisions in S. 1678 which waive at least three statutes currently prohibiting the export of SPR oil delivered from the Naval Petroleum Reserve and the Alaskan North Slope. Barriers against U.S. crude exports during a supply crisis could be eliminated at the worst possible time.

S. 1678 also provides for a waiver of cargo preference requirements for SPR oil which would be shipped to offshore refineries, with the refined petroleum products then shipped back to domestic markets. This measure is a direct threat to national security, as it represents an unfair competitive advantage to Caribbean refineries and in essence exports domestic refining capacity.

V. EXPEDITED LEGISLATIVE ACTION REQUIRED

It is difficult to believe that the Congress intended utilization of the SPR in the manner which DOE has prescribed. It appears that changes must be accomplished through limited legislative action on an expedited basis.

Although existing authorities are sufficiently flexible to accomplish recommended improvements in SPR policy administratively, without new legislation, the National Council is concerned that Administration actions to date have clearly demonstrated a reluctance to make necessary adjustments.

The progress which is made now, between disruptions, in advancing emergency preparedness capabilities will determine whether the next disruption becomes yet another crisis in which we are again our own worst enemy--or a capably-handled non-event. In view of the volatile state of world affairs, there may not be much time left before the next disruption.

The National Council cannot emphasize too strongly that major flaws concerning when and how the SPR is to be utilized during a disruption must be satisfactorily addressed if the nation is to get its SPR house in order. Other improvements raised by S. 1678 are in and of themselves insufficient to raise emergency preparedness capabilities to an acceptable level.

We are pleased to have the opportunity to offer our views to the Committee on an issue of vital concern to the National Council, and will remain available to answer any questions.

October 19, 1983

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ATTACHMENT A

October 12, 1983

The Need for an Effective Drawdown Plan for the Strategic Petroleum Reserve

I. The Current Plan: Price Competitive Sale

DOE's Strategic Petroleum Reserve (SPR) crude oil drawdown plan [Amendment No.4, transmitted to Congress December 1, 1982 and effective that date] provides for distribution of SPR crude oil **primarily by price competitive sale.**

- 1. Sales would be open to **all interested buyers;** awards would be made to the highest bidders, **REGARDLESS OF NATIONALITY OR AFFILIATION.**
- 2. Under a "last resort option," up to 10% of the SPR sales volume in any given month could be distributed under the allocation regulations in 10 CFR Part 220.

II. The Current Plan: A PRESCRIPTION FOR ECONOMIC DISASTER

"In the most realistic test of how the U.S. government would deal with a new world oil crisis, the Reagan administration's **free-market approach turned an oil shortage into a national 'economic disaster,'"** according to reports by 10 states that participated." [Enclosure 1, "Oil-Crisis Test Yields Economic Disaster," The Washington Post, September 19, 1983]

III. Price Competitive Sale is Fundamentally Inequitable

- 1. **Creates uncertainty** as to access to crude oil.
- 2. **Generates unnecessary inflation** particularly since non-refiners may make speculative bids on SPR crude oil.
  - a. U. S. would seek highest possible prices.
  - b. Foreign producers would react with price increases, impacting upon both U. S. and allied economies.

- c. Speculators--even the foreigners who created the disruption--can buy SPR crude oil. Speculators can hoard crude oil, add to refiner acquisition costs, or divert crude oil to inefficient uses [e.g., boiler fuel], **all at the consumer's expense.**

IV. **Price Competitive Sale [Auction] Ignores Lessons Learned**

- 1. Significant product shortages and much higher prices can result from relatively minor crude oil disruptions.
- 2. Shortages are magnified by public perception and reaction.
- 3. Failure to have in place an effective program for managing crude oil disruptions will trigger great turmoil--gasoline lines; economic hardship particularly for the poor and disadvantaged; regional shortages; and, in general, a public clamor for federal and state action.
- 4. Government involvement in oil disruption management is most effective at the crude oil level, less effective at the product level, and least effective in a rationing program.
- 5. Crude oil allocations under the EPAA did provide essential crude oil to crude short refiners and did help eliminate distortions in the supply and distribution system.
- 6. Inventories in the private sector cannot be counted on to offset disruption-related shortages. Inventory behavior is counter-cyclical, with storage tanks filled during a crisis, and drawn down between crises for economic reasons. Inventories presently are at minimum operating levels.

V. **Petroleum Disruption Impacts Heavily on the Agricultural Sector**

- 1. Much of the U. S. agricultural system lies at the end of the petroleum distribution network, where shortages are most likely to hit first and hardest.

- 2. A disruption of short duration at the wrong time can result in crop losses or sharply reduced yields, for an entire year. For example, crop losses caused by a 10% fuel shortage could lead to a 55% increase in farm commodity prices.
- 3. A doubling of energy costs can permanently raise food prices by 12%, or $30 billion annually, if fully passed through.
  - a. In the short term, however, the farmer as a "price taker" in a truly competitive market must absorb such cost increases; beyond the farm gate, cost increases can be more readily passed on.
  - b. In a period of economic depression on the farm, a recurrence of sharp energy price increases could seriously impair the ability of many farm families to survive.
- 4. Fuel shortages also affect food processing and distribution operations, causing spoilage losses and preventing some food from reaching the consumer.
- 5. **The consumer** is ultimately the big loser.

VI. **Needed: An Effective SPR Drawdown Plan**

The National Council of Farmer Cooperatives (NCFC) is convinced that any SPR distribution plan must conform to the following goals if it is to **serve national and economic security interests:**

- 1. **Minimize** and eliminate where possible the **adverse effects of regional and national shortages.**
- 2. **Minimize economic damage** caused by the ratchet effect of permanent, disruption-driven energy price increases.
- 3. Help **maintain agricultural and other essential services.**
- 4. **Reduce supply uncertainty** by establishing well in advance of any disruption a workable, efficient distribution plan.

- 5. **Minimize government intrusion** not only through timely and effective response but also by the rapid termination of the distribution plan once the disruption has been brought under control.

The most efficient means of accomplishing these goals for **the benefit of consumers and the economy** is to ensure the **timely distribution of crude oil** among the nation's refiners serving domestic markets.

VII. **The Solution**

The current "free-market" distribution plan [Amendment No. 4] was formulated arbitrarily without benefit of review by the Congress or the public. Tests of the "free-market" approach [see Enclosure 1] indicate that the plan yields "economic disaster" and does not, therefore, serve national interests.

To avoid economic hardship and to maintain essential services during a petroleum disruption, DOE should develop an effective drawdown plan for the Strategic Petroleum Reserve, consistent with vital national interests. The SPR distribution plan must be subjected to public comments and should be based on experience gained in previous disruptions.

Accordingly, NCFC recommends that a revised SPR distribution plan be developed which would incorporate the following features:

- 1. **Timely and effective utilization** of sufficient quantities of SPR crude oil as a response mechanism, **early** in the disruption. This is the least intrusive method of (a) offsetting regional and national shortages, (b) reducing panic behavior, and (c) mitigating crisis-driven price increases--all for the benefit of the consumer and the economy.

- 2. **Distribution** of SPR crude oil **of suitable quality** to be made only to **domestic refineries in operation** at the time of the disruption. This most closely replicates the normal market infrastructure and facilitates efficient movement of petroleum to areas of need.

- 3. All SPR crude oil to be sold **at a pre-determined market price**, with appropriate adjustments for crude quality. The price should be reflective of the total market, and not panic conditions embodied in incremental barrel prices during a crisis.

- 4. Such price levels and distribution procedures to be consistent with the attainment, to the maximum extent possible, of national objectives, as stated in the Energy Emergency Preparedness Act (EEPA) of 1982 and the Energy Policy and Conservation Act (EPCA) of 1975, as amended, **including the maintenance of agricultural and other essential services.**

- 5. Behavior of **spot market prices**, during a known disruption, to be used **as a lead indicator in the decision to trigger SPR drawdown.** This warning signal reflects a composite of basic factors, including private inventory levels, regional shortages, failure or inability of the refining and distribution system to adjust to shortages, panic purchases, and expectation of future supplies. A study should be conducted to determine the most appropriate spot market warning device, with procedures established now--before the next crisis.

- 6. A thorough, **actual drawdown test** of the SPR plan to be implemented in order to detect and eliminate problem areas and thereby enhance confidence in the abilities of the SPR.

- 7. Purchasers of SPR oil to be **required to refine** the crude oil and **inject the refined products into the marketplace** in a timely manner. Exchanges should be permitted, to facilitate logistics of moving crude oil.

Other improvements in contingency planning would complement and enhance the effectiveness of a revised SPR drawdown plan:

- 8. An Advisory Board to be comprised of high level representatives from a cross section of the oil industry and the user community. Such a Board would serve a variety of important functions in time of crisis, including the following:
    - a. To advise the Secretary of Energy and the President.
    - b. To evaluate marketplace behavior.
    - c. To make recommendations with respect to SPR drawdown.

- 9. Limited anti-trust release to be provided to Advisory Board members, to the extent necessary for the performance of Board duties.

- 10. Pre-emption of inconsistent State laws to be carefully crafted. Such pre-emption should be sensitive to the role and rights of States during emergencies.

- 11. Specific provision to be made for a uniform State set-aside, covering up to 5% of refined petroleum products. The set-aside would enable the States to address local shortages not already corrected by the SPR drawdown.

- 12. International Energy Agency (IEA) anti-trust exemption to be extended. The U.S. must act in concert with its allies in any energy disruption. Proper coordination requires the continued participation of the major oil companies.

VIII. TIME IS OF THE ESSENCE:

Existing authority is sufficiently flexible to accomplish national goals with respect to the SPR, without new legislation.

However, the Administration has clearly demonstrated its reluctance to make necessary adjustments to the SPR drawdown plan. **Legislation is required.**

It is vitally important to **our national and economic security** that the necessary modifications to the present SPR drawdown plan be expedited.

It is essential that progress be made now, **while the nation has breathing room,** in advancing our emergency preparedness capabilities. Without such progress, this nation may once again demonstrate that we are our own worst enemy. In view of the state of world affairs, there may not be much time left before the next disruption--**the nation must get its SPR house in order.**

The Washington Post

[illegible] MONDAY, SEPTEMBER 19, 1983 [illegible]

Oil-Crisis Test Yields 'Economic Disaster'

By Milton R. Benjamin
Washington Post Staff Writer

In the most realistic test of how the U.S. government would deal with a new world oil crisis, the Reagan administration's free-market approach turned an oil shortage into a national "economic disaster," according to reports by 10 states that participated.

The type of crisis postulated in the two-month test, coordinated by the International Energy Agency, was very similar to what could occur, government and industry analysts said, if further escalation of the Iran-Iraq war cuts the flow of Persian Gulf oil.

"The threat of such a thing happening is very serious. And I'm not talking about six months from now. I'm talking about six weeks," said James Akins, a Middle East expert and former ambassador to Saudi Arabia, who forecast the 1973 Arab oil embargo.

Since completion of the test June 17, The Washington Post has obtained internal government documents, evaluations by the 10 states that participated and three IEA reports providing the most detailed look to date of how the Reagan administration would deal with a new oil crisis and what the impact would be on the United States.

In the exercise, which hypothesized a partial blockage of oil exported from the Persian Gulf, the Reagan administration took no regulatory action and let the price of crude oil, now $28.63 a barrel, rocket to $90.

This huge increase, which sent the retail price of gasoline and home heating oil soaring to more than $3 and $4 a gallon in some parts of the United States, had the effect of lowering consumption in this country by 18 percent.

The administration contended that the test thus proved that letting the free market determine the price of oil in a crisis would reduce consumer demand sufficiently to eliminate the need for government regulation to restrain prices and consumption or allocate supplies.

"This is a significant achievement and reaffirms the validity of President Reagan's market-based approach to energy emergency preparedness," Assistant Energy Secretary William A. Vaughn declared following completion of the exercise.

But strong disagreement came from states par-

See OIL, A21, Col. 1

Oil-Crisis Test Yields 'Economic Disaster'

OIL, From A1

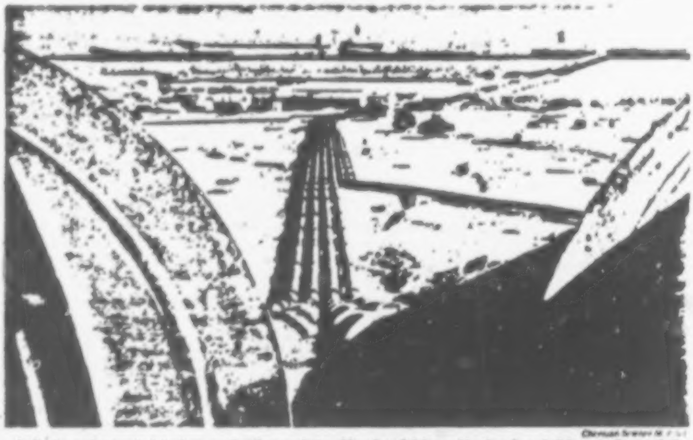
ticipating in the test, which surveyed widespread business and industrial shutdowns, bankruptcies, massive unemployment, commuters unable to afford gasoline, farmers abandoning their crops and low-income and elderly residents without heat or electricity.

"The administration's refusal to deviate from its allocation-by-price scenario transformed the petroleum crisis into an economic disaster in which petroleum supplies were adequate for those who could afford them," the Vermont State Energy Office said in a post-mortem.

Florida Gov. Robert Graham's Energy Office, criticizing the administration's "general disregard for the enormous and social costs" of its approach, urged that "the federal government's policy of total reliance on the uncontrolled market . . . be reconsidered."

The 20 other nations belonging to the IEA, formed at U.S. urging in 1974 to coordinate efforts of the industrialized world to minimize the impact of future oil emergencies, also were highly critical of the Reagan administration's decision to let the price of oil soar.

"The whole idea behind the IEA is to keep emergencies from resulting in vastly higher oil prices," a Dutch official said. "That can't work if the other 20 countries are trying to restrain demand and hold down prices and the United States allows the price to go through the ceiling."



[illegible]

An Iranian tanker terminal. Analysts say they fear escalation of Iran-Iraq fighting could reduce flow of oil from the Persian Gulf.

The Test

The IEA's emergency system depends on the willingness of its members—the major European industrial nations plus the United States, Japan, Canada, Australia and New Zealand—to share the pain equally in a major world oil disruption.

If forecasted oil supplies fall short of historical use by more than 12 percent, each member country is required to cut domestic consumption by 10 percent. The IEA then activates a sharing system to ensure that available supplies are distributed equally among members.

To test the system, the IEA periodically notifies members that a hypothetical disruption has taken place. Members then devise a new supply plan based on the amount of oil available, and the IEA calculates which nations should share oil.

The countries and their member oil companies then hypothetically redirect oil supplies to mitigate the crisis.

This test, the fourth since the agency's creation, was to be particularly significant. For the first time, the IEA planned to include the element of price.

But at an IEA Governing Board meeting last Oct. 28, the United States suddenly announced that it opposed any consideration of pricing.

A major reason for the switch, Energy Department official Romulo L. Diaz Jr. explained in a subsequent memorandum, was "concern that a simulated world price would erode support in the Congress for the president's market approach to energy emergencies."

While the other IEA members, according to State Department memos, strongly opposed the switch, the United States, as the most important member of the agency, prevailed. No price information would be generated as part of the test.

Hence, the other countries "expressed shock when, in its first official communication in the test, the Energy Department announced that by its calculations, world oil prices would increase to $90 per barrel in the month following the hypothesized oil supply interruption," Deputy Assistant Secretary of State E. Allan Wendt reported in a memo June 3.

The Free Market

In addition to the U.S. government, 19 major American oil companies belong to the IEA.

Under a special antitrust exemption, they provide information on world oil supplies and movements to the IEA secretariat. In a crisis, the IEA would rely to a great extent on member oil companies to make the sharing system work.

Each country asks its oil companies to "volunteer" as much oil as can be spared to meet that country's sharing obligations.

Most oil companies have indicated since formation of the IEA, however, that they would not volunteer to divert supplies to other countries—at the risk of not having enough for regular customers—unless guaranteed that all oil companies would be equally disadvantaged.

To achieve this, most member countries established so-called "fair sharing" programs. Until 1981, the United States accomplished this under the domestic crude oil allocation system.

In early 1981, however, the Reagan administration abolished oil allocation and price controls. The oil industry, while generally welcoming deregulation, nevertheless noted that a standby fair-sharing system was needed. The industry also reiterated that it would not volunteer to share oil in an emergency unless such a system was in place.

The Energy Department, however, has not established such an emergency program and did not use the fair-sharing system in the test.

Instead, to meet the U.S. obligation to provide 22 million barrels of oil to other IEA nations, the administration relied heavily for the first time on voluntary pledges from independent oil companies and large industrial users, including U.S. Steel, Monsanto Co., Union Carbide, Burlington Industries, Inc. and Corning Glass Works.

In the opinion of several government officials, the appeal to many of these companies to volunteer oil was blatantly political.

Deputy Assistant Energy Secretary Ronald L. Winkler, in a memo April 29 seeking help from outside companies, said: "If we cannot demonstrate that the free market and voluntary programs work, even during this simulation, that will be turned against us up on the Hill."

Vaughn, in a letter to General Motors Corp. Chairman Roger B. Smith urging him to aid this "important test for the Reagan administration's market-based energy programs," said:

"Your company's participation in making simulated voluntary offers would greatly assist in demonstrating that mandatory and intrusive government regulatory programs are not needed to respond to energy emergency situations and that cooperative and voluntary programs will, indeed, do the job."

Smith, whose company volunteered to surrender some of its oil during this mock emergency, later wrote Energy Secretary Donald P. Hodel declaring: "The success of the test reaffirms our belief that President Reagan's market-based approach is the best way to deal with the issue of emergency preparedness."

While non-IEA member companies volunteered to provide 35.8 million barrels of oil, letting the United States comfortably exceed its sharing commitment, many industry and IEA observers expressed doubt that this oil would be available in a real emergency.

"Oil company representatives participating in the allocation system in Paris found many of these offers dubious," the State Department's Wendt said in the June 3 memo. "Oil was reported in locations where no oil facilities exist, or in vessels too large to enter the specified port or in quantities greater than the United States normally imports.

"In response to IEA questions, DOE acknowledged that, in the press of tight deadlines, they had 'made up' details relating to some of these offers," Wendt added.

"Even as they were playing the game, the Reagan administration manipulated the statistics and tried to manipulate the behavior of the oil companies," Sen. Howard M. Metzenbaum (D-Ohio) charged. "The oil companies involved viewed the administration's role as nothing short of naked political coercion designed to justify their no-controls philosophy."

The States

U.S. allies' concern about how the administration's approach would affect them in a new oil crisis was at least matched by the 10 participating states.

Despite the administration's insistence through most of the test that free-market allocation would move petroleum products to where they are most needed, New York and California each reported a fuel oil shortage on the East Coast and a glut in the West.

Maine's Office of Energy Resources complained that during the test "no administration spokesman confronted the real crisis: the hardship created by the huge increase in oil prices.

"The tourist industry faces a bleak summer . . . . Many schools, hospitals and mills have suffered. Coal prices have also skyrocketed due, we suspect, to hoarding," Maine reported.

"Our utilities have also been hard hit . . . and are seeking emergency rate hikes. We are hearing from many consumers who cannot afford to heat their homes and/or hot water and commute to work," Maine added.

"The impact of the disruption and high energy prices on the low-income group would be devastating," Florida said.

All of the states echoed Wisconsin's complaint that the federal government "had abdicated its responsibilities for formulating a comprehensive economic response package."

In its final hypothetical message to the White House, the Wisconsin Division of State Energy said: "Although Milwaukee's situation is severe, there are several other major U.S. cities in worse shape.

"We hope it will not take the economic collapse of one of these cities, probably ensuing riots and accompanying destruction and death, before the administration realizes that its policies have failed the country and must be changed."

Nor was the hypothetical crisis in the IEA exercise the most severe oil shock possible.

A Congressional Research Service study released yesterday examined two other Persian Gulf disruption scenarios and concluded that they could produce a catastrophic drop in the U.S. Gross National Product of as much as 28 percent.

"Looking at the IEA test results, looking at the comments from our allies, from the oil companies themselves and from the states, the Reagan administration's approach clearly does not pass the test," said Rep. Mike Synar (D-Okla.), whose House Government Operations subcommittee is to open hearings Thursday on U.S. preparedness for oil emergencies.

"I believe in the free market, but I am a pragmatist," he said. "Reality dictates that something more than the free market is going to be necessary in a crisis."

National Council of Farmer Cooperatives
1800 MASSACHUSETTS AVENUE, N.W. • WASHINGTON, D.C. 20036 • TELEPHONE (202) 659-1525

WAYNE A. BOUTWELL
President

October 14, 1983

(INDIVIDUAL LETTERS TO THE ENTIRE SENATE AND THE HOUSE ENERGY AND COMMERCE COMMITTEE)

The Congress carefully crafted the Energy Emergency Preparedness Act of 1982 (P.L. 97-229) around sound national objectives. Unfortunately, inappropriate application of the "free market" ideology to emergency conditions by DOE has yielded potentially disastrous contingency plans. New drawdown plans for the Strategic Petroleum Reserve (SPR) call for oil to be auctioned to the highest bidder. Anyone could bid, including foreign governments!

The recent AST-4 Test conducted by DOE also revealed serious flaws in total reliance on the market during an oil emergency. In that simulation test, crude oil prices more than tripled, with massive adverse macro-economic impacts. Yet, the analysis reaffirmed the Administration's policy to withhold general use of emergency authorities, and SPR oil was not used to offset shortages. The DOE declared the test a success.

A "laissez-faire" approach under such circumstances is unacceptable. The consumer and the U.S. economy end up as big losers.

It is difficult to believe that the Congress intended utilization of the SPR in the manner in which DOE has prescribed. We ask your help in securing needed changes. The progress which is made now, between disruptions, in advancing emergency preparedness capabilities will determine whether the next disruption becomes yet another crisis in which we are again our own worst enemy--or a capably-handled non-event.

The enclosed White Paper discusses proposed improvements in SPR drawdown policy. We would be pleased to discuss this vital issue with you at your convenience.

Sincerely,

Wayne Boutwell

Wayne A. Boutwell

Enc.

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October 20, 1983

Honorable James A. McClure
Chairman
Committee on Energy and Natural
  Resources
361 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

I would like to supplement the National Council's prepared statement for the October 19, 1983 hearing on emergency preparedness with a few brief comments concerning the basic thrust of our concerns and recommendations.

The National Council is firmly convinced that the SPR Drawdown Plan as presently structured runs directly counter to national and economic security objectives in dealing with an oil disruption. An auction to a total universe of buyers--with strong indications that the intent would be to use the SPR late, rather than early, in a disruption--promises to yield disastrous results if called upon in a time of need. These concerns were strongly reinforced by the Department of Energy's testimony.

An oil disruption poses three serious problems. First, physical shortages jeopardize essential services, restrict economic activity and create gasoline lines. Second, rapid price increases become semi-permanent, with devastating impacts on our economy over the longer term. Third, overwhelming political pressures quickly develop, as the first two problems emerge.

The Congress would then be asked to "fix it" in the midst of crisis. As we are sure that you are aware from past experience, this is an untenable, "no win" position. The SPR presents a unique opportunity to minimize shortage and price difficulties, and thereby reduce political pressures.

However, until the SPR Drawdown Plan and philosophy of use are modified to address shortages and price increases in an effective manner which serves to reduce panic behavior, the political problem will threaten to activate with a vengeance. Impacts, even remotely approaching those in the AST-4 scenario, will generate irresistible constituent pressures. Assurance that "the market works best" will prove to be a totally inadequate response. Regardless, the American consumer and the economy will end up paying an unnecessarily heavy price.

The National Council's prepared statement offers modifications to S. 1678 which focus upon major flaws in present contingency plans, regarding when and how the SPR is to be utilized during a disruption. The probing questions which you raised during the hearing indicate that you share our concerns. Unless these central problems are satisfactorily addressed, the nation cannot get its SPR house in order. Although other proposed improvements in S. 1678 prove useful, they alone are insufficient to raise emergency preparedness capabilities to an acceptable level.

Mr. Chairman, a significant irony became evident during the hearing debate. Movement of oil to accommodate IEA obligations was continually couched in terms of "fair sharing." Yet, for this nation's own domestic needs, the Administration is committed to an auction to a total universe of buyers. If the latter approach is so good for this nation, why not apply an auction open to everyone, including OPEC producers and the Soviet Union, to meet international needs? Obviously, we believe that such an approach would be disastrous, domestically or internationally.

You raised a question to Senators Durenberger and Andrews about how to avoid discouraging preparedness efforts in the private sector while developing and making public a sound SPR drawdown plan. Unfortunately, available evidence strongly indicates that private inventory behavior is counter-cyclical. Participants in the oil industry and the user community maintain minimum inventory levels between crises, and only fill emergency reserves at the worst possible time--at the onset of a crisis. Securing long-term contracts is not an adequate answer either, as most such supply contracts have "emergency out" clauses. We have not found an equitable means of addressing either concern.

In conclusion, it is difficult to believe that the Congress intended utilization of the SPR in the manner in which DOE has prescribed. Although most changes might be accomplished administratively, under existing authorities, we are firmly convinced that such measures must be prescribed through limited legislative action on an expedited basis. We stand ready to support your leadership efforts in this regard.

We would like to request that this letter be incorporated as part of the October 19, 1983 hearing record.

Respectfully yours,

R. Thomas Van Arsdall

R. Thomas Van Arsdall
Vice President, Agricultural Inputs
and Services

RTVA:sn

STATEMENT OF THE
INDUSTRIAL OIL CONSUMERS GROUP
CONCERNING S. 1678
BEFORE THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

October 19, 1983

I am Jan B. Vlcek of the law firm of Sutherland, Asbill & Brennan, counsel to the Industrial Oil Consumers Group ("IOGC"). The IOCG is a group of industrial consumers of petroleum which have joined together to address the major legislative and regulatory issues confronting industrial oil users. The current members of IOCG are Anheuser-Busch Inc., Armco Inc., Bethlehem Steel Corporation, Cone Mills Corporation, Firestone Tire and Rubber Company, and General Motors Corporation. The purposes of the IOCG are outlined in the Group's statement of founding principles, a copy of which is attached. We appreciate the opportunity to appear before you today to discuss S. 1678 and administrative actions needed to enhance our energy emergency response procedures.

As a preliminary matter, the IOCG believes that the most important step taken with respect to our nation's emergency preparedness in the last decade was the decision by the Reagan Administration to redirect the Government's efforts from reliance on price controls and Government allocation toward reliance on free markets and the Strategic Petroleum Reserve. In our view this has improved significantly our Country's ability to weather an interruption in oil supplies. We know from experience that price and allocation controls introduce uncertainty and inefficiencies that only worsen the losses that result from sudden changes in oil availability.

We believe that reliance on market forces to allocate supplies, supplemented by the effective and timely use of SPR, can minimize our vulnerability to, and losses from, disruptions in oil supplies.

I. The Importance of the Strategic Petroleum Reserve in Emergency Preparedness

In IOCG's view, the single most constructive and potent tool available to the United States to mitigate the impact of possible future interruptions is the Strategic Petroleum Reserve. The most effective way to be prepared for an interruption is to have a large SPR at the ready to facilitate the operation of the free market during a disruption. In addition, a fully developed SPR should reduce the probability of future interruptions. A 750-million barrel SPR, for example, could provide up to 4.5 million barrels per day of additional oil supplies during a shortage for a period of almost six months, enabling the Government to alleviate substantially the adverse economic effects of the shortage. The kind of direct help which a sizeable SPR can provide simply cannot be duplicated by oil allocation and price controls -- which again and again have only served to aggravate, rather than mitigate, the effects of an oil interruption.

Currently, the SPR contains over 360 million barrels of oil. This is equivalent in size to about 3 months of all current U.S. imports, which have been averaging less than 4 million barrels per day. At the current maximum drawdown rate of 1.7 million barrels per day, the SPR could offset a loss of almost half of our current imports for seven months.

In evaluating U.S. vulnerability to serious oil disruptions, it is important to consider not only the total volume of U.S. oil imports but also the source of these imports. In 1979, oil imports from Arab OPEC averaged three million barrels per day. In 1982, imports from Arab OPEC averaged less than 1 million barrels per day. At the same time, U.S. sources of oil have become more diversified, and countries such as Mexico and the United Kingdom have taken on a more important role as oil suppliers. The current SPR is equal to over one year of our current level of Arab OPEC oil imports, even if no additional conservation or fuel-switching were to occur.

II. Administrative Actions to Improve our Energy Emergency Response Procedures - A Proposal for Use of the Strategic Petroleum Reserve

IOCG supports the revised Drawdown Plan as submitted by the President last year because it provides the President with the needed flexibility to cope with a future oil interruption. Our support is based on the fact that IOCG has developed a specific proposal, the adoption of which would be possible within the parameters of the drawdown plan. The IOCG program has the following general characteristics:

(1) Drawdown should be accomplished in a manner which replicates the operation of the free market to the maximum extent possible based on the results of free market sales.

(2) Some SPR oil should be promptly released at the beginning of an interruption so as to provide a rapid response to the emergency.

By employing a market-oriented drawdown program, combined with prompt release of some SPR oil at the very outset of the emergency, this process will yield an efficient, prompt, and effective response to an emergency, mitigate the initial oil price surge which would occur without a rapid response and reduce the temptation to return to inefficient, cumbersome and ineffective government controls.

In order to achieve prompt drawdown of the Reserve as soon as an interruption occurs, we believe that conditional sales of rights to SPR oil should be held before an interruption. This approach can have a significant positive effect on the benefits derived from use of the SPR. In particular, early drawdown of the SPR will temper sudden price hikes. Early use of the SPR can alleviate panic buying, contribute to more stable shortand long-term purchasing decisions by oil companies, provide information to the government and private parties regarding the availability and price of oil on the world market, and forestall hasty and ill-conceived political responses, such as possible Congressional action to re-enact price and allocation controls and demand restraint measures. Thus, use of a modest amount of SPR oil at the outset of an interruption can have a substantially more positive effect on oil prices than drawdown of an equivalent amount of oil later in a shortage.

Specifically, our pre-interruption and initial drawdown proposal would operate as follows:

(a) Beginning immediately (e.g., November 1983) regular auctions for sale of rights to a limited amount (no more than 10%) of SPR oil, to be released during an emergency, would be held. The sale of rights to oil obtained at an auction would last for approximately 30-90 days or until the next auction.

(b) All bidders at the auction should have executed agreements with DOE with definitive terms so that the details of the transaction are agreed to and understood prior to the declaration of an emergency.

(c) The amount of oil subject to the auction could not exceed the lower of an amount approximately equal to one week of imports or 10% of the SPR.

(d) The President could establish a "minimum bid price" for each auction to assure adequate revenues to the government and encourage private storage. For example, the "minimum bid price" could be the spot market price immediately preceeding the auction, plus a premium of perhaps 5-10 percent.

(e) The President should make the findings required to permit drawdown as soon as the interruption occurs or is detected in order to permit the early drawdown process to accomplish its objective of reducing the initial oil price surge.

(f) Once drawdown begins following the President's declaration of emergency, a successful bidder would be free to sell or exchange his SPR oil. This would maximize efficient distribution of the oil and enable companies that did not submit successful bids to obtain SPR or replacement oil. (Attached as Appendices A and B are fuller descriptions of the mechanics of the pre-interruption sale and a scenario illustrating how this sale would operate prior to and during an interruption.)

If the President decided that further drawdowns were necessary following initial SPR drawdown under the mechanism described above, any future drawdown would parallel the sales process described above, except that the President would be free to vary the timing of the sales, the amount of SPR oil to be sold at each auction, and the "minimum price," if any.

If the market is permitted to operate as freely as possible during an oil interruption, relative stability in oil supply and demand will occur within a reasonable time, making potential buyers unwilling to pay more for SPR oil than spot market prices. As a consequence, bids for SPR oil will decline and ultimately terminate, thus automatically "detriggering" drawdown once the marketplace has adjusted to the new supply condition.

With respect to the issue of potential logistical problems during a drawdown period, IOGC believes that the pre-interruption auction system takes care of a major administrative problem, i.e., the selection of buyers, prior to drawdown. Additionally, IOCG agrees with statements made by DOE in the Drawdown Plan, to the effect that the Plan properly deals with issues concerning the physical distribution of SPR oil. We also agree with DOE that the SPR storage system has been designed to make maximum use of existing and planned private distribution facilities. Our evaluation of the situation indicated that the SPR distribution system is structured so that oil from the SPR could be injected readily into the commercial distribution system. While it would be naive to assume that no logistical problems will arise during an oil emergency with the physical distribution of SPR oil, IOCG believes that, by locating SPR storage sites "in areas that are highly accessible to major commercial distribution system," and by turning the responsibility for distribution of SPR oil over to the buyers as soon as the oil has been moved to "supporting terminals " DOE has minimized the possibility that such logistical problems will be more substantial than those normally experienced in the distribution of crude oil and refined petroleum products.

II. S. 1678

If the administrative actions described above were adopted, additional statutory authority would generally not be necessary. As we have indicated, IOCG believes that free market mechanisms, buttressed by use of the SPR, should be relied upon to the maximum extent possible both to reduce vulnerability to a severe energy supply interruption before it happens and to respond to such an interruption if it occurs. IOCG's position is supported by a number of recent Government studies, making it abundantly clear that this Nation cannot afford a repetition of the oil pricing and allocation program under the Emergency Petroleum Allocation Act which encouraged consumption, misallocated petroleum supplies and led to an almost incomprehensible array of complex and ambiguous administrative regulations. Market forces and the discipline of energy price changes will be far more effective in encouraging conservation and efficient use of alternative energy sources than Federal regulatory programs.

IOCG believes that DOE's current emergency planning efforts, as embodied in its report entitled "Comprehensive Energy Emergency Response Procedures," correctly follow the market-oriented approach to energy emergency planning. The report makes clear that the keystone of DOE's preparedness program is reliance primarily on market mechanisms to respond to disruptions in energy supplies, buttressed by the SPR and the Defense Production Act where necessary to meet the petroleum needs of the military.

However, if legislation is deemed to be necessary by the Congress, there are some features of S. 1678 which could help to improve and upgrade our energy emergency response procedures; other parts of the bill tend to be counterproductive and could reverse the progress in energy policy that has been made in moving from a Federal interventionist approach to a reliance on market forces.

Set forth below is IOCG's views on each of the major provisions of S. 1678:

1. Energy Emergency Executive Reserves

IOCG has long felt that appropriate emergency planning requires input from the private sector and that industrial consumers have a role to play in such planning. The current maze of burdensome disclosure and conflict-of-interest requirements have a substantial chilling effect on such participation. Recent attempts by DOE to establish manpower reserves for various commodities were severely hampered because many potential participants were discouraged from involvement by the restrictive qualification requirements.

The new Section 273 will, by allowing the President flexibility to exempt essential private personnel, provide a reservoir of talent and experience to supplement the efforts of salaried government personnel in implementing energy emergency response procedures.

2. Voluntary Agreements and Plans of Action

On its face, this provision provides opportunities for oil consumers to participate with other private sector parties in drawing up agreements and plans of action for response to a domestic or international energy emergency. It balances the need for antitrust immunity for entities participating in such a process with the public interest requirements of full monitoring and notice to appropriate government agencies of actions being taken by private parties. IOCG is concerned, however, that this mechanism not be abused. These provisions should include proper representation of entities affected by the action that groups actually involved in this process take. For example, it is conceivable that voluntary agreements and plans of action will, as does their counterpart under the aegis of the International Energy Agreement, involve allocation of petroleum products, substituting private actions for the actions that the federal government was taking in the 1970's. The selection of participants in this process is critical and every effort needs to be made to insure that the point of view of all affected parties, especially consumers, is represented.

3. Extension of International Energy Program Antitrust Immunity

IOCG considers the anti-trust immunity an important mechanism to allow the International Energy Program to function.

We are concerned about one factor, however, and that is the exclusion of industrial consumer participation in the IEA decision making process, which is presently dominated by petroleum companies.

Under current procedures, the petroleum industry has very considerable input into--and substantial control over--decisions made for the voluntary allocation of oil by the International Energy Agency ("IEA") during a severe energy supply interruption. The United States oil industry formally participates in decisions of the IEA through advisory committees consisting solely of oil companies, and informally through periodic consultations with the various IEA standing groups (comprised of senior personnel from the energy departments of the participating countries) or with the IEA Secretariat.

Indeed, the primary method of allocating oil supplies in an emergency under the IEP is intended to be through voluntary allocations instituted by the oil companies. In this regard, DOE's regulations broadly authorize oil companies to take such action as may be necessary to implement emergency allocation programs of the IEA including arrangements for the purchase, loan, sale, or exchange of petroleum products by and among themselves, or with other persons.

Thus, the oil industry enjoys a virtually exclusive role among private entities in influencing IEA decisions and in making and implementing allocation decisions which may materially and adversely affect United States oil consumers.

The decisions made can have adverse regional or even user-specific effects. Moreover, because of the highly integrated nature of the economy, such decisions can have a "ripple" effect as well, damaging other regions or specific users indirectly. For example, a decision by an oil company to redirect crude oil originally destined for midwestern refineries and consuming markets to an international market under the IEP Agreement could not only adversely affect, say, manufacturing concerns in that region which consume oil, but also businesses in other regions which are dependent on those manufacturers for supplies. Thus, the method selected by the oil companies for allocating oil under the IEP Agreement may have as much impact on the severity of the hardships felt during an emergency oil interruption as does the overall amount of oil reallocated to other nations under the IEP.

The likelihood that the interests of industrial consumers could be endangered because of the one-sided structure of the IEA is by no means remote. This is true not merely because the oil industry does not have the same concerns as industrial consumers, but because the oil industry often has concerns which are adverse to those of industrial consumers in terms of the handling of oil shortages.

At the Department of Energy, progress has been made as far as industrial consumer participation is concerned. For example, in the recent AST-IV exercise industrial consumers were, for the first time, allowed to participate. Such involvement by a sector of the economy which is so basically affected by policy relating to oil supply and price is essential.

4. Reduction in the SPR Fill Rate

As previously indicated, IOGC believes that the Strategic Petroleum Reserve is the cornerstone of our emergency response capability. As such we support an aggressive fill rate for the Strategic Petroleum Reserve and especially support the increase in the requirement for the final level of the Reserve from 500 million to 750 million barrels.

IOCG believes that the SPR should continue to be filled expeditiously. Whether the fill rate should be 220,000 barrel per day, 186,000 barrels per day, or 145,000 barrels per day, is, however, a difficult issue which involves a complex interplay of factors, including the relative cost of oil today versus the likely cost in the future, the impact of an increase in the fill rate on the projected Federal deficit and capital markets and any physical limitations on the amount of oil which can be stored. In determining the appropriate fill rate for the reserve, we urge that the following factors be considered. First, this is a particularly propitious time for filling the SPR, given the current "oil glut" and relatively low world oil prices. Viewed from another perspective, purchase of oil now at a rapid rate for the SPR may give the United States an appreciating asset which may pay for itself many times over in the event of an oil crisis.

On the other hand, IOCG is concerned that the problems which currently exist regarding the federal budget, and a National debt that has surged beyond the $1 trillion mark, may be exacerbated if attempts are made to develop the SPR fill rate too rapidly merely to achieve a fixed, arbitrary fill rate. Moreover, given that our oil imports have fallen to more manageable levels, and our SPR is in excess of 360 million barrels, it may not be prudent at the moment to spend the additional sums which would be needed to increase dramatically the SPR fill rate. Thus, while we believe that the SPR is an important national security program, expenditures for the SPR must be balanced against competing budgetary priorities.

5. Preemption of State Laws

IOCG is greatly concerned about proposed section 275(a) for several reasons. First, while the provisions of S. 1678 do not contain any authority for the federal government to allocate or place price controls on crude oil or petroleum products, we are concerned that as this bill moves through the Congressional process amendments providing for such controls could very readily be added. Indeed, state preemption, by precluding state action, could become a principal reason cited for the need for Federal price and allocation controls.

Second, such a result would be most troublesome because it was our experience as industrial oil consumers during the 1970's that state governments acted far more quickly and with greater appreciation for local needs in responding to oil shortages than did Federal bureaucracies. States issued timely decisions providing petroleum products to keep our plants running in contrast to backlogged federal government personnel who were often far removed from our plant location and from the local concerns. In other words, our experience tells us that the states are in a far better position to meet the needs of their citizens, are demonstrably more attuned to local and regional differences, and are able to act in a more rapid fashion to respond to those differing needs.

Finally, we are concerned that implementation of these provisions could readily require the development of a large federal infrastructure charged with providing review of state energy emergency contingency plans to determine, under Section 275(a)(2), whether a specific state law or regulation should be exempted. This would be, in our view, a counterproductive move back toward a system where the distribution of petroleum products was subject to control by Federal government decisionmakers.

6. Protection of Private Inventories

IOCG strongly supported efforts by this Committee to provide protection of private consumer inventories from government seizure in the context of the Standby Petroleum Allocation Act. We remain concerned that the threat of governmental allocation of petroleum products endangers our efforts to be self-reliant in dealing with petroleum supply problems. On the other hand, it would be inconsistent for us to oppose the wholesale preemption of state law provided in Section 275 and support federal preemption of state laws with respect to petroleum inventories. In our view, our inventories are not now threatened by state law and we do not foresee this being a problem in the future. We will continue to engage in a dialogue with state governments to acquaint them with our needs in the context of an energy emergency and to encourage them not to interfere with our efforts to prepare for petroleum supply interruptions.

CONCLUSION

On balance, IOCG believes that there is sufficient administrative authority, particularly with respect to the development of a pre-crisis sales and early drawdown program for the SPR, to respond to a petroleum supply interruption. If legislation is enacted, S. 1678 could provide useful additions to our nation's response capabilities in the form of the authority for executive reserves, the extension of the IEA antitrust immunity, and the provision for increasing the size of the Strategic Petroleum Reserve. IOCG does not, however, believe that the bill should extend to preemption of state law.

This concludes our prepared statement. We will be pleased to respond to any questions that you may have.

FOUNDING PRINCIPLES
OF THE
INDUSTRIAL OIL CONSUMERS GROUP

Market forces, unencumbered by governmental allocation, price controls or usage restrictions should be allowed to govern petroleum supply and demand decisions to the greatest extent possible.

Government tax, resource and regulatory policy should encourage development of domestic crude oil resources.

The Federal Government should not impose any industrial end use taxes or mandatory conservation measures on petroleum usage.

The domestic refining industry needs to be capable of providing efficient processing of the widest varieties of available crude oil supplies to insure the availability of petroleum products.

Government energy policy should recognize that petroleum is only one part of the energy equation.

Government and private reserves of crude oil and petroleum products are an important mechanism for dealing with any supply shortage. Private industrial reserves must not be appropriated to resolve scarce supply situations.

In an energy supply emergency, distribution of scarce supplies should be left to the private sector to the maximum extent feasible. Any government allocation plan should insure that petroleum products are equitably available to the private sector.

APPENDIX A

CONTINGENCY PLANNING: STRATEGIC PETROLEUM RESERVE DRAWDOWN PLAN

This Appendix details the mechanics of the proposed Strategic Petroleum Reserve (SPR) Drawdown Plan.

I. Prior to Presidential Declaration of Energy Emergency

A. All operable refiners interested in obtaining oil from the SPR will:

1. negotiate a Basic Sales Agreement with DOE defining terms of payment, compliance with necessary government regulations, penalties for nonfulfillment, etc.

2. provide straightforward confirmation that the administrative and physical procedures needed to promptly accept the oil are in place.

3. establish their financial ability to purchase the oil by posting a bond analogous to the OCS bonding system.

B. DOE will administer the monthly auctions as follows:

1. DOE will issue an invitation to all qualified refiners (see Section I, Paragraph A) to bid on the oil under the terms specified. Bidders will be notified that the bids submitted will be effective for one month, or until the next auction. All bids will describe the price, quantity of oil, other considerations such as

the distribution network (pipeline, tanker, etc.) which will be used in receiving the oil.

3. Review the bids. Within 10 days the DOE will notify the successful bidders and publish a list of all bids in the Federal Register. DOE retains the right to reject any and all bids.

   Both successful and unsuccessful bidders will be notified of their relative priority for purchasing oil and of the effective date that the new bids replace those of the previous auction. Joint bids should be allowed to encourage smaller refiners to participate.

II. At the Time of an Emergency

Once the President declares an emergency:

A. DOE will immediately notify the successful bidders that they will be awarded the oil on the terms bid and request delivery instructions;

B. SPR oil will be released at the fastest possible drawdown rates consistent with bidder's needs. Thus, oil companies will receive SPR oil on a schedule consistent with their capabilities, starting immediately (i.e. in hours) after the President declares an emergency.

D. Any oil not claimed (or scheduled for delivery) by a successful bidder within a fixed period (e.g. one month) after the declaration, will be made available to the next highest bidder in the sale (or added to the amount available for a subsequent sale).

E. Successful bidders can elect not to accept the oil. However, those who do not accept the oil will be subject to a penalty in the event of a default. This penalty should be set at a level which will reduce the prospects of speculative bids without, however, rising to a level which would force the companies to accept oil from the reserve if the price increases have moderated.

III. Post-Presidential Declaration Drawdown Period and Action Subsequent to an Emergency

The automatic drawdown process will continue until the established percentage of the SPR has been released (all bids successfully filled). If at any time after the initial automatic drawdown and before the President declares the emergency over adequate supplies of oil become available to bidders at prices below the bid price, they will be permitted to stop receiving oil. In the second and subsequent auctions after the initial automatic drawdown, this will be without penalty, encouraging bidders to stop the drawdown when it is not economically justified and thus avoid excessively depleting the reserve. Once the President declares the energy emergency over, the normal periodic pre-emergency sales procedures begin again.

APPENDIX B

CONTINGENCY PLANNING: STRATEGIC PETROLEUM RESERVE DRAWDOWN SCENARIO

This Appendix sets forth a hypothetical situation wherein the proposed "Strategic Petroleum Reserve Drawdown Plan" is implemented.

Background

For some months, the world oil market has been stable and the Rotterdam spot market price for Arabian Light is hovering around $32 per barrel.

U.S. oil imports are averaging about 6 million barrels per day.

The SPR has reached a fill level of 400 million barrels and has a maximum drawdown rate of 2 million barrels per day.

Eighty (80) bidders have qualified to bid for SPR oil and have been participating in periodic sales held by the DOE to determine who will get the initial oil withdrawn from the SPR in the event of an emergency.

At a January sales the total SPR oil available for bid was set by the DOE at 40 million barrels. The DOE exercised its discretion over bid prices by establishing a "minimum bid price" of $33.50 ($1.50 above the January spot market price) */ per barrel. Thirty bidders responded and 23 bids were accepted and prioritized as follows:

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*/ All dollars in this paper are constant 1982 $.

Company	Amount of Crude (millions of barrels)	Bid Price ($ per barrel)
A	2.0	34.50
B	2.0	34.45
C	2.0	34.25
D	2.0	34.15
E	2.0	34.00
F	2.0	34.00
G	1.8	34.00
H	1.5	34.00
I	1.0	34.00
J	1.0	34.00
K	1.2	34.00
L	1.5	34.00
M	2.0	34.00
N	1.5	33.90
O	2.0	33.75
P	1.2	33.60
Q	2.0	33.55
R	1.8	33.50
S	2.0	33.50
T	2.0	33.50
U	2.0	33.50
V	1.5	33.50
W	2.0	33.50
	40	

During January a significant "event" occurs in the Middle East and Rotterdam spot market prices began to move upward. In February, oil available for scheduled import decreases in supply and oil prices escalate. By March, Rotterdam spot market prices are ratcheting upward at a rate approaching $2 per barrel per month and during April, the amount of imported oil reaching the U.S. is beginning to decrease. The DOE and the President are monitoring this situation closely.

In the meantime, the January bids have lapsed because no Presidential declaration of a severe supply interruption was issued before the next sale. Sales were held in February, March and April with the bid prices steadily creeping upward.

Scenario

In May the President declares an "energy emergency" setting in action the automatic drawdown of the SPR. Forty million barrels of SPR oil are made available for distribution under the contract terms of the April sale. At that sale with a minimum bid price of $37.50 per barrel 40 bidders responded. Twenty-seven bids were accepted by the DOE and prioritized as follows:

Company	Amount of Crude (millions of barrels)	Bid Price ($ per barrel)
A	2.0	39.00
B	1.0	38.90
C	2.0	38.85
D	1.0	38.84
E	2.0	38.81
F	2.0	38.76
G	1.5	38.76
H	1.8	38.76
I	1.2	38.76
J	1.0	38.76
K	1.0	38.76
L	1.5	38.76
M	1.5	38.76
N	2.0	38.70
O	2.0	38.65
P	1.2	38.55
Q	1.8	36.50
R	1.0	38.50
S	2.0	38.50
T	2.0	38.50
U	1.5	38.50
V	1.0	38.45
W	1.0	38.40
X	1.0	38.35
Y	2.0	38.30
Z	1.0	38.25
A1	1.0	38.25
27	40	

The following is a schedule of SPR oil release and related events during the initial (automatic) drawdown.

Date	Event
May 28	The President issues declaration of an energy emergency under section 3(8) of EPCA.
May 30	The SPR oil starts to flow. Initial flow rate is 500,000 barrels/day.
May 31	The Rotterdam spot market price reaches $39.00 per barrel and is ratcheting upward.
June 10	The SPR oil flow rate has reached 2 million barrels per day and all companies are receiving oil.
June 15	The Rotterdam spot market has reached $39.50 per barrel.

Additional sales using this approach could be held in May and later months until the President found that the emergency was over. The volume to be available at each auction and the minimum bid price would be set by the President based on conditions prevailing at the time of the sale.

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November 15, 1983

The Honorable James A. McClure
Chairman
Committee on Energy and Natural Resources
United States Senate
Washington, D.C.

Dear Senator McClure:

Enclosed are the responses to the questions submitted by the Committee minority.

Sincerely,

Jan B Vlcek

Jan B. Vlcek

JBV:avs
Enclosure

RESPONSE TO SENATE ENERGY COMMITTEE QUESTION NO. 1

Because of the harmful impact of past oil supply interruptions on the economy and industry in general, the Industrial Oil Consumers Group members are concerned about the potentially serious harm to the economy which could result from a future oil disruption, particularly if the Federal government responds to such interruptions with the same counterproductive price controls and supply allocation policies which were implemented during the 1970's. For these reasons, the members of IOCG, long before AST-IV, have expended substantial effort to formulate a number of specific proposals for dealing with future energy emergencies. These proposals, including prompt drawdown of the SPR, are discussed in more detail in our written testimony. We believe that these measures, coupled with maximum reliance on the free market, can substantially cushion the impact of future disruptions and reduce and delay the increase in the price of oil which would otherwise occur.

As part of its activities in this area, IOCG monitored the progress of the AST-IV exercise and some IOCG members agreed to make simulated voluntary offers in response to requests from the Department of Energy. These companies made oil available for use within the marketplace to help reduce the size of the shortfall. With respect to the question about becoming oil exporters, the companies did not impose any restriction on the use or resale of the oil which they made available. The decision by participating IOCG members, including General Motors, to make these offers was predicated on a scenario specified by the International Energy Agency for AST-IV and on the economic and operating conditions for the period of time simulated by AST-IV (*i.e.*, April through June, 1981). Among the critical considerations which affected these determinations were (1) the affect on the economy given, the scenario portrayed, (2) the participants' inventory and actual usage during the 1981 period that the IEA chose as the time frame for the test and (3) the fact that price and allocation controls were not in effect at that time.

These offers typically reflected conservative estimates of the amount of oil which would have been available at that time. Should a supply interruption arise in the future, however, when different market conditions or different inventory and usage levels in the individual companies exist than was the case in 1981, the reaction of IOCG members to the making of voluntary offers obviously may differ.

Specific actions such as the making of voluntary offers will, as we have indicated, vary depending on the conditions in the national economy, related future economic projections and the companies' total energy supply and usage requirements when and if an actual oil disruption occurs. Operating decisions will be made to produce goods and services as required by the marketplace circumstances, consistent with the long-term interests of the business enterprise and its shareholders.

The IOCG believes that the opportunity for consumers, as well as producers of petroleum products, to be involved in formulation and implementation of emergency response actions is vital to an effective response to an emergency. Past approaches which did not include consumers as participants have substantially narrowed the range of options and experience available to the government to deal with oil shortages.

RESPONSE TO SENATE ENERGY COMMITTEE QUESTION NO. 2

IOCG believes that adoption of our proposed program for a pre-crises sale and early drawdown of SPR oil would provide an effective mechanism to mitigate higher prices otherwise resulting from an oil supply interruption. In particular, early drawdown will temper sudden price hikes and alleviate the panic buying that might otherwise occur in an emergency. Our proposal is described on pages 3 through 8 of our written testimony.

RESPONSE TO SENATE ENERGY COMMITTEE QUESTIONS NOS. 3 AND 4

Determination of the proper fill rate for the SPR is a very complex question. It involves questions not only of emergency preparedness, but also of budgetary and economic policy. The many considerations which affect this determination are described in more detail in IOCG's written statement at pages 13 and 14. As indicated, IOCG favors the increase in the requirement for the final level of SPR from 500 million to 750 million barrels. We believe that to achieve that level the SPR should be filled as rapidly as possible subject, however, to the constraints imposed by the current deficit and the vulnerable condition of the economy. The 186,000 barrel per day rate recently adopted by the Congress represents, in our view, a balanced response to these competing claims at the present time.

RESPONSE TO SENATE ENERGY COMMITTEE QUESTION NO. 5

IOCG has long had serious reservations about the lawfulness and wisdom of the fair sharing program, insofar as it may be used as an indirect means of adopting an allocation program among companies participating in the IEA program. Therefore, IOCG does not support the use of fair sharing if it involves allocation of oil for domestic consumption, whether it applies to reporting or to non-reporting companies.

We believe that the President has ample authority under Section 251 of EPCA to accomplish the objectives of the IEA, including fulfillment of the United States allocation obligations, without imposition of the fair sharing program. Since Section 251 of EPCA only authorizes the President to take action which is "necessary" to meet our IEA obligations, and the fair sharing program is not necessary to meet those obligations, IOCG does not believe that "fair sharing" is authorized under Section 251.

Our skepticism about the need for "fair sharing" has been fortified by our experience in AST-IV. First, the United States met its full obligation to the IEA without imposition of the fair sharing program, even with an assumed disruption in world oil supplies at a time when SPR oil reserves were relatively small. Indeed, the total volume of voluntary offers was more than triple the amount required to meet United States' obligations under the IEA. Second, the total United States' obligation to the IEA under AST-IV was 23 million barrels which is less than 7% of the current size of the SPR. This suggests that the reduction in domestic supplies, which would arise if the IEA were implemented even in a major shortage such as that assumed for AST-IV, might be wholly offset by drawdown of the SPR with less serious adverse impacts on the economy. Thus, the potentially serious impact of a shortage, which served as the basis for the development of fair sharing proposals, may well have declined since the concept was first broached during the 1970's.

Finally, any disproportionate impacts on particular regions which might occur due to sales to IEA countries would likely be quickly corrected if the economy is given a chance to function without the constraints of price and allocation controls. If government intervention is deemed necessary, regional disparities could be avoided through less drastic action than full allocation of oil among refiners, which is the usual means suggested for dealing with interruptions. The Department of Energy AST-IV Appraisal Report noted that United States' obligations could be met on a basis which mitigated adverse regional impacts through drawdown of the SPR, with the option of directing up to 10% of the oil to specific companies, or by issuance of directed supply orders to a variety of companies so as "to ensure that the burden of participating in the IEP is not borne disproportionately by any one company or group of companies." (P. 7).

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

ON BEHALF OF

Independent Gasoline Marketers Council
1015 Eighteenth Street, N.W.
Washington, D.C. 20036

S. 1678 Energy Emergency Preparedness Act Amendments of 1983

Submitted by:

Jack A. Blum
Blum & Nash
1015 Eighteenth Street, N.W.
Washington, D.C. 20036
202-857-0220

October 18, 1983

My name is Jack Blum. I am the General Counsel of the Independent Gasoline Marketers Council, a trade association of nonbranded independent retailers of motor gasoline.

The Independent Gasoline Marketers Council has been deeply concerned with the issue of emergency preparedness. As the Chairman of this committee will recall, we supported his efforts to obtain legislation two years ago and we believe that legislation which defines the role of government is essential to protecting the United States in the event of another crisis.

The Council strongly supports the efforts of the Committee to increase the size of the Strategic Petroleum Reserve and provide for the construction of new storage facilities. The preemption provision is necessary to protect multi-state operations from states which use their own regulatory apparatus to gain advantage over neighboring states in a crisis.

One section of the present proposal is deeply disappointing and we believe will be counter productive to real emergency planning. It, combined with the administration's blind adherence to the "free market" solution to crisis, will convert an energy supply interruption into a national emergency which will produce financial chaos, severe crude and product shortages, transportation disruption and the destruction of the independent segment of the industry.

The section of the legislation to which I refer is §274 which permits the working out of voluntary industry plans and agreements for emergency response. The approach is one which has been proposed by major oil companies as the solution to every energy problem since the 1930's. Companies have asked for and received the opportunity to work together cooperatively at various times, usually in secret informal ways, and have received antitrust immunity for those agreements.

The only time company cooperation worked to promote the public interest was during World War II. Other adventures in industry cooperation have ranged from inept to catastrophic. When they have worked it has been to help the companies, not to help the country or the consumers.

A review of the record will support my observations.

The companies worked together during the first Suez crisis of 1957 to facilitate delivery of energy supplies to Western Europe. Limited antitrust immunity was granted for this exercise. The result was a tripling of European energy prices, a series of protests from European governments and a lengthy set of hearings by the Antitrust Subcommittee of the Senate to determine what had occurred.

Our government was forced to reassure the Europeans that we had not helped the companies pick their pockets.

Later, through a system of administratively agreed upon antitrust immunity, John McCloy on behalf of the major oil companies "informed the Antitrust Division of concerted company efforts to deal with supply crises." These efforts were totally extra-legal. The antitrust laws cannot be waived by the Attorney General, but in this case they were and the Attorney General agreed to accept reports from Mr. McCloy about the meetings and agreements. These agreements included the operation of the Iranian consortium with a voting mechanism for price stabilization, various "overlifting" agreements relating to production in Saudi Arabia and the ability to discuss "backing out" certain crudes in oversupply situations.

In an affidavit entered in a Senate Foreign Relations Committee hearing record on these antitrust exemptions, former Attorney General Mitchell explained that he learned of these exemptions when Mr. McCloy arrived at his office to inform him of the "understanding" and to say that it was made with every Attorney General since Robert Kennedy.

Similar antitrust immunity was granted for joint negotiations between the major companies and the oil producers in the Persian Gulf and in North Africa when the Lybians cut back production in 1972. The results of the negotiations were catastrophic, inasmuch as they led to a quadrupling in prices with no concomitant consumer benefit. The negotiating process was examined in detail by the Senate Foreign Relations Committee and the record confirms the ineptness of the negotiators.

The then President of Gulf Oil, Mr. Dorsey, said in a cable sent to the negotiations that as long as the companies involved in the negotiations were more concerned with protecting their own concession arrangements than they were with price there was no limit to the level that prices might reach.

Dorsey was absolutely correct. Left to their own devices, the companies wanted to protect "their" oil and "their concessions". They could have cared less about consumer prices or supply. We saw the resulting prices.

It was this dismal failure of secret inter-company cooperation that lead to the direct government intervention of the post-1973 period.

How any group of reasonable men could believe that a repeat of these failed policies would solve today's new problems is beyond me.

The Independent Gasoline Marketers Council has a direct, albeit parochial, interest. We do not believe that we would be included in important meetings sanctioned under this provision and we believe that our major company suppliers would use these provisions to destroy our businesses.

It is cold comfort that the Attorney General and the Federal Trade Commission would have the right to propose alternative plans and that the Attorney General may revoke a plan if adopted.

We have seen from the disastrous performance of the Federal Trade Commission under the stewardship of the present Chairman, Mr. Miller, and the inept leadership of Mr. Baxter at the Antitrust Division, that neither believes in the antitrust laws and that given the opportunity to ignore them they will. Mr. Miller has repeatedly refused to investigate antitrust complaints that the independent sector has called to his attention. Mr. Baxter has recited to Congress chapter and verse the benefits of size and vertical integration and has actually refused to enforce laws he doesn't like and has intervened on the side of law violators.

The numerous reports required by the section are so much waste paper inasmuch as they offer no remedy for injury.

The most astonishing portion of the legislative proposal is that an "approved agreement" would become a defense to a breach of contract action in a Federal or State court. One of the repeated positions of the administration has been that legislation is not needed to deal with an emergency because contract provisions can cover the situation. This would give the most powerful firms in the industry the opportunity to destroy their customers with impunity by breaching contracts. It raises serious constitutional questions and should not be taken seriously by this committee.

Another position taken by the "free market" advocates in the administration is that the very lack of a government program to help companies will give the companies an incentive to store oil and prepare for an emergency. If these provisions permitting "voluntary agreements" pass, that incentive will be nonexistant. The very concept of "voluntary agreement" is that agreement would all allow the companies to distribute the available crude and product in a rational fashion among themselves. Naturally this destroys the storage incentive.

At the outset of my statement, I referred to the disaster an "agreement" combined with no regulation would create. Consider the recent IEA exercise in which "free market" prices went to $98 a barrel. How high would they go if the companies could agree on price? At $98 a barrel, the economy would be in serious trouble because of the drain of funds from normal channels to pay for petroleum. At prices higher than that the crisis would be complete and drastic government action would become an immediate necessity.

Let me be blunt. We as independents don't believe that a meeting of major companies under Presidential auspices will help us in a crisis. We don't think it will help the consumers and we don't think it will solve any problems other than those of the majors in the meeting.

A reestablishment of the international petroleum cartel under government auspices is not a national energy emergency plan and should not be passed off as one. It is a form of state intervention on behalf of large corporations which is inimical to the free market system. It undercuts the administration's "free market" approach without providing a substitute.

We will fight this proposal every inch of the way. We will also continuously remind those who propose "company agreements" as a solution to a national crisis that they are in the role of abdicating government to a select group of corporations.

nojc

Testimony of

Phillip R. Chisholm
Executive Vice President
The National Oil Jobbers Council

Before the
Senate Energy Committee

Hearings on
S 1678

Washington, D.C.
October 19, 1983

PREFACE

The National Oil Jobbers Council is a federation of 42 state and regional trade associations representing thousands of independent small business petroleum marketers. Members include gasoline and diesel fuel wholesalers, commissioned distributors of gasoline, gasoline reseller-retailers and a large number of retail fuel oil dealers. Members also wholesale or retail many other petroleum products, including kerosene, LP gas, aviation fuels and motor oils as well as residual fuel oil. Together our members market approximately 50 percent of the gasoline and 35 percent of the home heating oils sold in America under either their own private brand or the trademark of their supplier.

The National Oil Jobbers Council (NOJC) is a federation of 42 state and regional associations representing 12,000 small business marketers of motor fuels and heating fuels. Altogether these businesses supply nearly 50 percent of the gasoline, 85 percent of the heating oil and 80 percent of the agricultural fuels consumed in this country. Because of our supply relationships with domestic refiners and because of the critical position we occupy in the distribution chain in the time of a domestic or international energy shortage, the NOJC is particularly sensitive to legislative proposals such as S. 1678. While we appreciate the opportunity to testify on this legislation, we are struck by the contrast between these proposed amendments to the Energy Policy and Conservation Act and an earlier effort by this Committee to construct an effective standby response to an energy emergency. We fully supported that earlier effort and opposed the President's veto of a bill of which this Committee had every reason to be proud.

Of particular concern to us is Section 3. This Administration has repeatedly insisted that the free-market will suffice in the event of future supply disruptions. It appears the premise of this bill, however, is that the free market only works if participants are allowed to meet and develop so-called voluntary agreements and plans of action under the umbrella of a broad exemption from federal and state requirements, including the antitrust laws.

As we understand Section 3, private interests ranging from major corporations to consumers are permitted to develop private agreements or "plans of action" in response to either a domestic or international energy emergency. On the surface this appears to be a very reasonable program until one begins to wade through the remainder of the language. This language constructs a maze of antitrust protections, defenses against private rights of action, and provides great Administrative or Presidential fexibility to circumvent the so-called review periods for the "plans."

Even given the most narrow interpretation, the language could offer the major oil companies the most incredible opportunities to abrogate supply contracts and discriminate in their pricing policies all in the interest of dealing with a petroleum shortfall. Fearing just such actions led NOJC and other groups to vigorously endorse emergency standby price and allocation plans. This legislation not only fails to authorize such standby plans but epitomizes the very actions we think should be be prevented. The fact that all a company needs is the signature of the Justice Department, the Federal Trade Commission and the Department of Energy to embark upon their action is little consolation. Given the level of the Administration's commitment to the principles which underpin our antitrust laws and the view that price is the best allocator of supply, NOJC is hardly reassured that these plans won't work to the detriment of both small business marketers and the millions of consumers they supply.

It is clear that the inspiration of Section 3 is the antitrust exemption provided to implement the International Energy Agreement. Under the international agreement the need for governments and refining companies to have enough flexibility to deal with the allocation agreement is clear and responsible.

While such limited exemptions may be justifiable on an international basis to deal with a supply shortfall, the same rationale can not be applied to dealing with domestic disruptions. Theoretically, a future shortfall could be one of two types. A disruption of limited duration in which "voluntary agreements" and "plans of actions" arrived at during the shortage could have long-term impact on the competitive structure of the petroleum industry. The second would be a long-term disruption in which the government response should clearly be not to lift protections of existing laws but to actively enforce those very laws against those which may wish to take advantage of the situation. After all, in the event of a shortage who should be making the tough decisions of whether the family in Massachusetts freezes or the farmer in Kansas is unable to get his crops out of the field? Reviewing this legislation we are not at all comfortable with what the answer to that question may be.

NOJC has several other questions. For example, what exactly is the proposal designed to accomplish? Who are the principal beneficiaries? Once the program is triggered, what terminates it? Are there arrangements to deal with long-term consequences of voluntary agreements made during the shortage? Once the shortage abates, what terminates these voluntary agreements? The questions concern us; the answers will likely concern us more.

If the free market is the perfect solution, as this Administration insists, then why is this legislation needed? Does the free market only work if individuals and/or companies receive sweeping protections against both Federal enforcement of antitrust laws and private claims brought against voluntary action plans?

I would also like to comment briefly on the inclusion of the state preemption language in Section 6 of the bill. We fully supported the inclusion of this language in the original standby legislation because we felt that the standby federal authorities could have been adversely affected by well-meaning but potentially conflicting programs initiated by the states. The state preemption in that case helped fill a vacuum. However, the inclusion of state preemption language in S. 1678 appears to broaden the vacuum created by the current absence of standby federal emergency response authorities, and therefore, the preemption needs to be re-evaluated in terms of the potential risks which might be involved. By prohibiting some state responses to an emergency are we potentially running the risks of precluding an effective program?

NOJC appeared before this Committee in September 1981 to explain our support of a limited standby energy emergency program. (See attached). The arguments we made are no less compelling now than they were then. We know from sad experience that the nation is unprepared; the industry is unable to objectively allocate scarce resources equitably; and the government will be forced to attempt to manage the crisis when we were already deep into difficulty. To date, nothing that this Administration has done has persuaded NOJC that a real crisis can be averted or managed any better today than it was in the past. In fact, we feel that it is clear from the results of the AST-4 test that our worst fears are confirmed. (See attached). Further, those fears have become justified paranoia as we begin to fully appreciate the scope of Section 3 and the protections it will provide our competitors.

Mr. Chairman and members of the Committee, I can only urge in the strongest possible terms that you seriously ask yourselves if the antitrust protections provided in Section 3 are needed. The most obvious beneficiaries are not consumers or small business. The effects of the section are obvious. If competition is to be maintained and millions of consumers served, especially in rural areas, you must eliminate Section 3 of the bill. It serves no purpose other than to promote anticompetitive and predatory behavior.

Thank you for the opportunity to appear. I will be happy to answer any questions you may have.

Testimony of

William Quortrup
President

Before the
House Energy and Commerce Subcommittee
on Fossil and Synthetic Fuels

Hearings on
Standby Energy Emergency Planning

Washington, D. C.
September 9, 1981

PREFACE

The National Oil Jobbers Council is a federation of 47 state and regional trade associations representing thousands of independent small business petroleum marketers. Members include gasoline and diesel fuel wholesalers, commissioned distributors of gasoline, gasoline reseller-retailers and a large number of retail fuel oil dealers. Members also wholesale or retail many other petroleum products, including kerosene, LP gas, aviation fuels and motor oils as well as residual fuel oil. Together our members market approximately 50 percent of the gasoline and 90 percent of the home heating oils sold in America under either their own private brand or the trademark of their supplier.

Mr. Chairman, Members of the Committee:

My name is William Quortrup. I am President of the National Oil Jobbers Council (NOJC). The NOJC is a federation of 47 state and regional associations which represent 22,000 independent petroleum marketers. These marketers sell more than 50 percent of the motor gasoline and more than 85 percent of the home heating oil sold in the United States. Our membership markets more than 90 percent of all the fuels consumed in rural and agricultural America. Virtually all of our members are classified as small businesses by S.B.A. standards.

We are pleased to be able to comment on the definite need for the nation to have in-place by September 30th, of this year, a stand-by system for the management of a petroleum shortage at either the national level or on a regional basis. We feel strongly that such a stand-by program should be designed so as to strike a fair and equitable balance between the needs of rural America and urban centers.

During the embargo period of 1973-1974, the NOJC supported the Emergency Petroleum Allocation Act (EPAA) despite our reservations concerning government involvement in our small businesses. However, we later discovered the problems associated with getting out from under federal controls. What should have been an eight month program ended up an eight year problem for independent marketers. In 1973, with the crisis upon us, the nation truly did not have the time to do the job the right way; however, Mr. Chairman, now there is time to do the job right. Thus, we congratulate you and the committee for your foresight in holding these hearings on stand-by controls authority.

I should mention that the 1973-1981 controls period was not a boon for independent small business petroleum marketers. During the first 14 months of controls NOJC lost 2,500 member companies. During the eight year controls period we lost some 8,200 companies. We came to believe, the hard way, that once the job of regulating our industry was fouled up, attempts to improve the regulatory program over eight years only made it worse.

Nevertheless, we believe that this nation does need a stand-by allocation and price control program to be implemented in the eventuality of a cut-off of our imported petroleum supplies. We are, however, adamant that any such authority and program have a built-in sunset provision to get us out of controls and back to a normal marketing environment as soon as the shortage has abated.

Our reasons for supporting such a stand-by authority are: first, we feel that after September 30th and the expiration of the EPAA the existing statutes including the Petroleum Marketing Practices Act (PMPA), federal anti-trust laws and supplier-purchaser agreements are inadequate to insure equitable product distribution during significant product shortfalls. The protections afforded small businesses in the above laws and contracts are, for the most part, inaccessible to small businesses because of the time and expense involved in pursuing a remedy through the judicial system, and second, we feel strongly that free market forces are incapable of equitably managing a significant product shortfall and maintaining the competitive viability of the small business segment of the industry at the same time.

The 2.5-3 million barrel per day shortfall scenario which the National Petroleum Council suggests as the trigger for federal involvement would come far too late for nearly one-third of our membership. The 16-18 percent shortfall trigger suggested by the NPC could arrive after as many as 5,000 to 7,000 independent marketers had gone out of business. Such small marketers, in a free market shorfall management plan, would be placed on arbitrary refiner-imposed allocation fractions with little, if any, recourse to appeal and to seek alternate sources of supply. Under such a "free market" scenario as prices move to market clearing levels, jobber volumes, their limits on credit for fuel purchases and the product costs themselves, will be determined by our refiner-suppliers who are our fellow competitors at the marketing level of the industry. The combination of fewer gallons, with limited lines of credit and fast-rising product prices will place a significant number of our national membership in dire financial straits. Once the political pressures from such an imbalance occur a hurry-up controls program will do little, if anything, to restore the numbers of independent competitors lost to the industry and to their predominantly rural customers.

Therefore, we would urge this committee to provide the President with enough flexibility in determining a significant petroleum shortfall at a point well below even the 16 percent threshold suggested by the NPC report. We would also encourage the following parameters for the triggering of a stand-by program (determinations that a shortfall):

- will result or is likely to result in a substantial shortfall nationally or regionally of petroleum products;
- will not be manageable under any other emergency authorities;
- will persist for a significant period of time to threaten petroleum or petroleum product stocks; and,
- will have a major adverse impact upon the public health, safety or welfare, or on the national or regional economies.

Mr. Chairman, we also feel strongly that allocation regulation in the event of a shortfall should be coupled with price controls at all levels of production, refining and distribution. The price control structure should be kept simple and consistent accounting for inflation and the fast escalation of product cost.

Congress can't afford to ignore the implications of a shortage for motor fuel and heating oil consumers. If in fact small independent petroleum marketers are forced out of business, primarily in rural areas, the product distribution network will cease to exist. It is unlikely that a major oil company will pick up that network. This will then force the rural consuming public to go farther to obtain fuel, at of course, a higher price.

From the heating oil standpoint the problem is just as compelling. There is obviously a floor on the amount of heating oil a homeowner can forego before his or her home becomes uninhabitable. Therefore some mechanism must be in place to insure adequate living conditions. Residential consumers must be assured that they are given a priority over other nonpriority distillate customers.

Obviously, there need to be certain priorities of allocation as part of any national stand-by program. The regulations which will follow legislative authorization should be based upon priorities such as:

- protection of the public health, services and welfare;
- residential use of home heating fuel;
- maintenance of fuel supplies for agricultural production;
- preservation of an economically sound and competitive petroleum industry;
- equitable distribution of petroleum at equitable prices among all regions and areas of the United States and among all sectors of the petroleum industry; and,
- allocations for the exploration for, and the production of fuels and essential minerals.

NOJC members believe that the federal stand-by authority and program ought to be pre-emptive of all state and local laws and ordinances regarding allocation and pricing of petroleum products during a significant shortfall. State government, however, can and should have the authority to organize and manage set-aside pools of product to be distributed fairly based on need within the state. Generally speaking, our membership felt that most states conducted such set-aside programs equitably during the recent controls period.

In summary, we now have the time to put together a well thought out program to manage a significant petroleum shortfall without the pressures of a crisis upon us. We urge the committee to consider the competitive viability of the petroleum marketplace in developing legislative authority for such a stand-by program. If the federal government were to be prohibited from intervening in the event of a significant shortfall thousands of small business marketing companies and the millions of consumers they serve would find themselves in serious trouble.

Clarence Darrow once said "History repeats itself — that's the trouble with history."

As independent petroleum marketers, we learned several difficult lessons from the experiences of the 1970's. The nation was unprepared; the industry was unable to objectively allocate scarce resources equitably; and, government fell all over itself trying to manage the problem after we were already in it.

We urge the Congress to legislate the much needed authority to allocate and set prices in the event of a petroleum emergency and to order the drawing up of flexible and equitable regulations not more than 180 days after enactment.

I and my colleague, Mr. Michael Scanlon, would be pleased to answer any questions you might have.

Thank You.

MEMBERS OF THE NATIONAL OIL JOBBERS COUNCIL

NOJC represents these member associations:

Alabama Petroleum Marketers Association
Arizona Oil Marketers Association
Arkansas Oil Marketers Association
California Independent Oil Marketers Association
Colorado Petroleum Marketers Association
Independent Connecticut Petroleum Association
Petroleum Association of Delaware
Oil Heat Institute of Greater Washington (D.C.)
Florida Petroleum Marketers Association
Georgia Oilmen's Association
Idaho Oil Marketers Association
Illinois Petroleum Marketers Association
Indiana Oil Marketers Association, Inc.
Intermountain Oil Marketers Association
Iowa Independent Oil Jobbers Association
Kansas Oil Marketers Association
Kentucky Petroleum Marketers Association
Louisiana Oil Marketers Association
Maine Oil Dealers Association
Petroleum Council Of Maryland, Inc.
Michigan Petroleum Association
Mississippi Petroleum Marketers Association
Missouri Oil Jobbers Association
Montana Chapter Intermountain Oil Marketers Assn.
Nebraska Petroleum Marketers, Inc.
Independent Oilmen's Association of New England
New England Fuel Institute
Better Home Heat Council of New Hampshire
Fuel Merchants Association of New Jersey
New Mexico Petroleum Marketers Association
Empire State Petroleum Association, Inc. (N.Y.)
North Carolina Oil Jobbers Association
Northwest Petroleum Association
Ohio Petroleum Marketers
Oklahoma Oil Marketers Association
Oregon Oil Jobbers Association
Pennsylvania Petroleum Association
South Carolina Oil Jobbers Association
South Dakota Independent Oilmen's Association
Tennessee Oil Marketers Association
The Texas Oil Marketers Association
Virginia Petroleum Jobbers Association
Washington Oil Marketers Association
West Virginia Oil Jobbers-Distributors Association
Oil Jobbers of Wisconsin, Inc.
Wyoming Petroleum Marketers Association

National Oil Jobbers Council
1707 H Street, N.W.
Washington, D.C. 20006

E-83-199

ncjc

COMMENTS
OF THE
NATIONAL OIL JOBBERS COUNCIL

ON

THE DEPARTMENT OF ENERGY'S PARTICIPATION
IN THE IEA OIL EMERGENCY ALLOCATION TEST

SUBMITTED
TO THE HOUSE GOVERNMENT
OPERATIONS SUBCOMMITTEE ON ENVIRONMENT,
ENERGY AND NATIONAL RESOURCES

SEPTEMBER 28, 1983

Distribution: Executive Committee, Association Executives, Legislative Steering Committee, Committee Chairmen

The National Oil Jobbers Council (NOJC) is a federation of 42 state and regional associations representing 12,000 small business gasoline and heating oil marketers. We wish to commend the Chairman and the members of the Subcommittee for their review of the Department of Energy's management of the recent test of the United States' ability to rapidly and adequately respond to another oil shortage. The effects of a future shortage and the federal government's response to meet this country's petroleum needs are of critical concern to independent marketers and the millions of customers they serve. As suppliers of nearly 50 percent of the gasoline and 80 percent of the heating fuel to U.S. consumers, marketers know first hand how disruptive both logistically and economically, a shortage can be. NOJC has in the past criticized this Administration's lack of adequate planning and its total reliance on the free market to allocate supplies. Such policies ignore the experiences of past disruptions and the economic hardship created for a diversity of American citizens, including the low income, the agricultural community and the rural resident.

As a participant in the Emergency Sharing Allocation System Test (AST-4), NOJC would like to share with the Subcommittee our member's views of the test and of the adequacy of this nation's proposed response to a real emergency.

AST-4

NOJC participated in the test of the IEA allocations in May and June of 1983. In response to simulated developments and prices, NOJC's input during the test included warnings of possible supply shortages for our members and their customers and calling on DOE and Congress to respectively respond with adequate allocation measures and to hold hearings on the merging supply and allocation problems. (Copies of portions of the NOJC computer input are attached).

NOJC has no dispute with the operation of the test itself. In fact, we compliment the Department of Energy for including independent marketers and other sectors of the economy in the test group. In the past it is our understanding that the only test "players" were major oil companies. We, nevertheless, took the test seriously and remain concerned about the implications resulting from the test in terms of this Administration's commitment to emergency preparedness and the development of adequate plans to respond to an emergency in the event of another serious energy shortage. And while we were grateful for the opportunity to actively participate in the test and feel that such an exercise was valuable, we also feel that it highlighted many of the supply dislocation problems that NOJC has long predicted would occur if the free market is permitted to allocate supply during a shortage.

In substance NOJC would have to agree with many of the concerns raised by the GAO analysis and the testimony presented to the Subcommittee by states participating in the exercise. In light of those comments, our own members experience with the shortages of the 70's and our participation in the test the following comments should be made:

- While the test was hypothetical, its results reconfirm that the U.S. would experience a real economic crisis if another serious petroleum supply shortage develops. Such a crisis would put tremendous political and social pressure on the Administration and Congress to act to solve the problems created by the shortage.

- The test graphically illustrated that in a real shortage the government must act to soften the blow of rapidly escalating prices. It also must be able to assure that supplies of product are not misallocated. A surplus of residual fuel in California does not instantaneously alleviate a residual fuel shortage in New York.

- While economic models can be constructed to prove that price is the most efficient allocator of resources, in the real world hospitals have to be run, crops harvested, police vehicles fueled, commuters have to get to work and homes have to be heated. When agricultural interests are jeopardized, and communities start running out of fuel because they can't afford the price of energy, then the Administration and Congress will be forced to develop a quick fix that may be too late to soften the brunt of the economic disaster facing those communities, or not sufficient to address the problems arising from the shortage.

- It is critical that DOE at minimum recognize the huge political and economic crisis that another shortage would create and develop a meaningful response to that crisis. The AST-4 test, if nothing else, highlighted the grave weaknesses in this Administration's reliance on the free market to deal with future shortfall.

NOJC POSITION

During the Congressional effort to enact a standby emergency program, NOJC took a very straight forward position. We advocated a standby price and allocation control program with a strict sunset provision. Because present laws, including antitrust laws, are inadequate or inassessible to small businesses and because the free market is incapable of equitably managing a shortfall, NOJC continues to support the development of a standby price and allocation plan to protect the competitive viability of marketers. We think the best time to develop that plan is in a non-emergency environment, not during an emergency or after the emergency conditions have run their course. Since our membership supplies 90 percent of all fuels consumed in rural and agricultural America, such a plan would also help establish a balance between the needs of rural and urban centers. (A copy of NOJC's testimony before the Fossil and Synthetic Fuels Subcommittee on S 1503 is attached).

Marketers already know that the free market only works up to a point. This country learned some very difficult energy lessons during the 1970's. We were unprepared for shortages; the industry was in no position to allocate equitably; and government reacted too late and then as if to compensate over-reacted. This Administration must see the need to make some hard choices based on economic and political realities. It cannot continue to rely on the pristine theory that the free market is the answer to every world supply crisis. Such a view has the potential to be disastrous.

NOJC wishes to thank the Chairman and the members of the Subcommittee for the opportunity to submit comments on this vital subject.

Attachment

FROM: M.DECKER (DOE538) POSTED: TUE 7-JUNE-83 11:34 SYS 64
SUBJECT: SUPPLY SITUATION IN CALIFORNIA

AS THE SITUATION IN CALIFORNIA, AS REPORTED BY A. GANDARA ON MAY 24, CLEARLY DEMONSTRATES, THERE IS A NEED FOR THE ADMINISTRATION AND CONGRESS TO QUICKLY REVIEW THE POTENTIAL BENEFIT OF CRUDE OIL PRODUCT PRICE AND SUPPLY ALLOCATION CONTROLS. A DOUBLING OF FUEL OIL PRICES WILL EXACERBATE A TENSE SITUATION FOR BOTH CONSUMERS AND PETROLEUM PRODUCT DISTRIBUTORS. OUR EXPERIENCE DEMON-

--More--

STRATES THAT PRICE CONTROLS AND ALLOCATION OF PRODUCT ARE NECESSARY TO MAINTAIN PRODUCT FLOW EVENLY AND WITH MINIMAL DISTORTION. POST CONTROLS LOCKING A SUPPLIER TO A PURCHASER WERE FUNCTIONAL DURING EMERGENCIES, THEIR BIGGEST PROBLEM WAS THAT THEY WERE NOT LIFTED WHEN THE EMERGENCY SUBSIDED. NOJC REQUESTS THAT ADMINISTRATION AND CONGRESS SERIOUSLY CONSIDER REIMPOSING THESE CONTROLS WITH PROTECTION AGAINST THE CONTROLS CONTINUING INDEFINITELY.

SECONDLY, NOJC ESTIMATES THAT THE STORAGE CAPACITY AVAILABLE AT THE SECONDARY (JOBBER) LEVEL EXCEEDS 2.3 BILLION GALLONS. THIS BULK PLANT STORAGE IS OWNED OR LEASED BY THOUSANDS OF MARKETERS, THE MAJORITY IS LESS THAN 250,000 GALLONS PER BULK PLANT. HOWEVER, THIS IS VERY SUBSTANTIAL STORAGE THAT COULD AND SHOULD BE TAKEN INTO CONSIDERATION DURING AN EMERGENCY. AT THE TERTIARY LEVEL (HOMEOWNER) THE CAPACITY IS ESTIMATED TO BE APPROXIMATELY 4 BILLION GALLONS, AND THIS DOES NOT INCLUDE COMMERCIAL OR INDUSTRIAL STORAGE. THIS HOMEOWNER STORAGE IS GENERALLY INDIVIDUAL 275 GALLON TANKS. AN EFFECTIVE EMERGENCY RESPONSE OUGHT TO EVALUATE PROVIDING INCENTIVES FOR MARKETERS 2.3 BILLION GALLONS OF STORAGE CAPACITY) HOMEOWNER (4 BILLION GALLONS OF STORAGE CAPACITY) AND INDUSTRIAL AND COMMERCIAL STORAGE FACILITIES (UNABLE TO ESTIMATE, BUT SUBSTANTIAL) TO MAINTAIN STOCKS OF GASOLINE, HEATING OIL AND OTHER PETROLEUM PRODUCTS.

ROM: MARK DECKER (DOE538)
O: P. WINKLER (DOE503)
UBJECT: 2ND RESPONSE TO E. BGAVETT MEMO OF MAY 13, RE: MAY 9 "ECONOMIC
RESPONSE MEASURES"

UNDERSTAND THAT THERE ARE REPORTS THAT OIL JOBBERS/MARKETERS ARE STOCKPILING

ULE FUEL SUPLIES. WANT TO ASSURE YOU THEY ARE MAKING EVERY EFFORT TO MEET GRICULTURAL DEMAND IN MISSISSIPPI AND NOT UNDULY HOARDING FUEL. MARKETERS RE ACTING TO MEET LOCAL DEMAND FOR FARM SUPPLY. OUR CONCERN AT THIS POINT S THE CONTINUED AVAILABILITY OF DEISEL AND DISTILLATE FROM MAJOR OIL UPPLIERS. REPEAT THE NEED TO ASSURE THE CONTINUED FLOW OF PRODUCT FROM EFINERIES TO OUR JOBBERS. SITUATION DOES NOT APPEAR TO BE CRITICAL, BUT ONTINUED MOVEMENT OF PRODUCT FROM PRIMARY TO SECONDARY SOT STORAGG STORAGE ND DISTRIBUTION NECESSARY. REPEAT THAT RURAL AREAS ALMOST EXCLUSIVELY ERVED BY OUR INDEPENDENT DISTRIBUTION NT NETWORK.

LSO, REQUEST UPDATE ON ANY STATE OR AREAS WHERE A MORE SERIOUS SUPPLY ISRUPTION APPARENT. WILL ALSO INOFRM YOU IF WE HEAR OF ANY SERIOUS PROBLEM EVELOPING REGARDING SUPPLY AVAILABILITY TO JOBBERS. ONE APPARENT SO FAR. URRENTLY, NOJC IS MONITORING ON A STATE -BY -STATE BASIS LOOKING FOR THE PPEARANCE OF ANY SERIOUS DISRUPTIONS. REQUEST BRIEF STATE BREAKDOWN OF OUR ASSESSMENT OF PROBLEM AREAS WITHIN NEXT 30 DAYS WHERE SERIOUS DISRUPTION IKELY.

From: M.Decker
To:Ron Winkler (doe503)

E. Gavett (doe557)
Subject: NOJC response to May 13, "Economic Response Measures" Memo of May 9. The National Oil Jobbers Council will take appropriate action to notify NOJC MEMBER Associations in states where agricultural fuel supply is in a potential shortage. We agree with the Department of Agriculture and the state analysis that disruption can best be handled locally by CES and ASCS at county level. NOJC would like to know exactly where disruption is imminent so that individual fuel oil marketers can be notified and every effort must be made to assure that their traditional supplier(s) does not "panic" and create an unecessary shortfall or move product to more lucrative market in anticipation of higher prices in an anticipated shortage. We can assure that marketers will supply farmers as long as they have available supplies of diesel.

Diesel fuel is a substantial fraction of the crude oil barrel from the refinery process. As refineries crank out more gasoline to meet the summer gasoline demand, they should also be refining greater amounts of lighter oils like #2 distillate which is the base product for diesel.

Would like to know specifically where potential shortage is although you may already have notified. Will check my mailbox to see. Agree

also that agricultural users need priority for crop growing. Would urge players not to forget that the independent marketer also needs fuel available to serve this priority use in emergency. Rural areas almost totally served by independent small distributors of petroleum products. Are you giving any consideration to measures that will assure that these independents continue to receive product so that farmers are served? If not, suggest DOE establish this as an objective. Also suggest that "free market" may not protect fuel suppliers and therefore farmers and other essential users in the event of shortfall of product. Some thought needs to be given as to how to ensure the viability of agricultural suppliers when product gets short. NOJC will monitor supply availability in problem areas and inform you if it appears that ability to obtain fuel is evident by marketers.".S"
FO name
.ED

MEMBERS OF THE NATIONAL OIL JOBBERS COUNCIL

NOJC represents these member asscoiations:

Alabama Petroleum Marketers Association
Arizona Oil Marketers Association
Arkansas Oil Marketers Association, Inc.
California Independent Oil Marketers Association
Colorado Petroleum Marketers Association
Independent Connecticut Petroleum Association
Florida Petroleum Marketers Association
Georgia Oilmen's Association
Idaho Oil Marketers Association
Illinois Petroleum Marketers Association
Indiana Oil Marketers Association, Inc.
Intermountain Oil Marketers Association
Petroleum Marketers of Iowa
Kansas Oil Marketers Association
Kentucky Petroleum Marketers Association
Louisiana Oil Marketers Association
Maine Oil Dealers Association
Michigan Petroleum Association
Mid-Atlantic Petroleum Distributors Association, Inc.
Mississippi Petroleum Marketers Association
Missouri Oil Jobbers Association
Montana Chapter, Intermountain Oil Marketers Association
Nebraska Petroleum Marketers, Inc.
Independent Oilmen's Association of New England
Fuel Merchants Association of New Jersey
New Mexico Petroleum Marketers
Empire State Petroleum Association
North Carolina Oil Jobbers Association
Northwest Petroleum Association
Ohio Petroleum Marketers Association
Oklahoma Oil Marketers Association
Oregon Oil Jobbers Association
Pennsylvania Petroleum Association, Inc.
South Carolina Oil Jobbers Association
South Dakota Independent Oilmen's Association
Tennessee Oil Marketers Association
Texas Oil Marketers Association
Virginia Petroleum Jobbers Association
Washington Oil Marketers Association
West Virginia Oil Jobbers-Distributors Association
Oil Jobbers of Wisconsin, Inc.
Wyoming Petroleum Marketers Association

National Oil Jobbers Council
1707 H Street, N.W.
Washington, D.C. 20006

(202) 331-1198

Appendix II

Answers to Questions Submitted to the Administration

Department of Energy
Washington, D.C. 20585

November 2, 1983

Honorable James A. McClure
Chairman, Energy and Natural
Resources Committee
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed are answers to questions we received following the testimony October 19 of William Vaughan, Assistant Secretary for Environment, Safety, and Emergency Preparedness, on S. 1678.

The last group of questions was addressed to the State Department and the Department of Energy on the threat of oil supply disruption. DOE answered questions 3, 4, 5, and 8, and coordinated with State on their answers to 1, 2, 6, and 7. The State Department is returning their questions under separate cover.

If you have any questions, please call Diana Diamond or Tom Pretorius of my staff on 252-4277. They will be happy to assist you.

Sincerely,

Thomas H. Pretorius
for Robert G. Rabben
Assistant General Counsel
for Legislation

Enclosure

cc: Richard Grundy
Committee Staff

Al Astrin
Committee Printer

POST-HEARING QUESTIONS AND ANSWERS

Relating to The

OCTOBER 19, 1983, HEARING

Before The

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

WITNESS: WILLIAM A. VAUGHAN
ASSISTANT SECRETARY FOR ENVIRONMENT, SAFETY,
AND EMERGENCY PREPAREDNESS
DEPARTMENT OF ENERGY

GROUP ONE

AST-4

Question 1: Mr. Vaughan, the U.S. made 2 key assumptions in AST-4. First, we assumed that other nations, including our IEA partners, force-majeured our own SPR program, thereby reducing U.S. oil supplies and hence reducing our obligation to make voluntary offers to sell oil to IEA nations.

Second, we assumed for the first time that Non-Reporting Companies would make sizeable voluntary offers to sell oil to IEA countries.

Had those two key assumptions not been made, would the U.S. have met its IEA oil sharing obligation?

Answer: On the basis of actual U.S. experience during the Iranian crisis in 1979, the DOE simulated the force majeure of a portion of SPR deliveries from foreign sources. Our preliminary estimate of the volumes affected in May was 10 million barrels, of which approximately 6 million barrels were produced in the U.K. and approximately 4 million barrels were from non-IEA sources. This preliminary estimate was subsequently revised, based on further analysis of projected

1. Cont'd deliveries reflected in the AST-4 data base, to 6.2 million barrels for May and 4.8 million barrels for June. These volumes represent only a portion of the total foreign crude oil contracted for delivery to the SPR during the AST-4 time frame. New SPR solicitations after May 31 were halted, which had the effect of eliminating all SPR deliveries subsequent to June.

The reduction in projected imports had the effect of reducing U.S. allocation obligations by an equivalent amount, or approximately 11 million barrels for May-June. If added to the U.S. allocation obligation of approximately 24.5 million barrels over the 3-month allocation cycle, the U.S. allocation obligation would have totalled approximately 35.5 million barrels.
Net voluntary offers from both U.S. Reporting and Non-Reporting Companies (NRCs) totalled more than 55 million barrels during this 3-month period and, therefore, would have been more than sufficient to meet a U.S. allocation obligation at the higher level.

1. Cont'd With respect to NRCs, the U.S. made no assumption regarding their performance during the test. NRCs were invited to participate and they made significant voluntary offers. These offers were carefully verified and deemed credible by DOE. Had the NRCs not made any offers, the total net U.S. offers (i.e., eliminating IEA swap arrangements between RCs and NRCs) would have totalled approximately 17 million barrels. These offers alone would have been approximately 7.5 million barrels short of meeting the U.S. allocation obligation over the 3-month allocation cycle. Under IEA procedures, the U.S. would have been requested to seek further voluntary contributions from U.S. companies, and, if necessary, to consider mandatory supply orders. The U.S. did, in fact, draft mandatory supply orders as a contingency and was prepared to consider their implementation, as well as the option of SPR drawdown, if necessary to meet U.S. obligations.

Question 2: In AST-4, didn't the United Kingdom express their surprise to us that our government assumed that oil from the U.K. destined for our SPR was force-majeured? In fact, didn't we assume that oil was *not* delivered to us, while the U.K. assumed *it was* delivered throughout the test?

Answer: During the AST-4 exercise month of May, all suppliers of foreign oil to the Strategic Petroleum Reserve (SPR), with one exception, were third party traders. Our simulated *force majeure* of SPR deliveries assumed that these third party suppliers could not or would not deliver these volumes and that they had invoked *force majeure* provisions in their contracts with the U.S. Government. One U.S. Reporting Company supplying foreign oil to the SPR in May was not included in this simulation since this would have involved altering that company's Questionnaire A which had already been submitted to the IEA.

This simulation paralleled actual U.S. experience in 1979. The origin of the oil was not a factor in the decision to simulate this event, nor was it assumed that the country of origin had invoked *force majeure* provisions in its contracts with intermediate companies in the supply chain.

2 Cont'd

Approximately 60% of the foreign oil covered by the *force majeure* action orginated in the United Kingdom (U.K.). It was not possible to resolve the manner in which the differences in import/export data between the U.S. and the U.K. should be handled for May data submissions to the IEA because of the constraints of the exercise. Therefore, these shipments were not reflected in U.S. imports, but were included in U.K. exports to the U.S.

The U.S. and U.K. later entered into bilateral discussions to deal with these data differences in the second month of the test. During these consultations, the U.S. was made aware of the sensitivity of this issue to the U.K. We were careful to explain our motivation to preclude any implication that we regarded the U.K. as an unreliable source of supply in the event of a disruption. Although this data issue could not be resolved during the exercise, both parties agreed that this and similar issues should be reviewed following the test.

2 Cont'd

The IEA data system is reviewed routinely to determine what improvements, if any, can be made. Because of problems in data submissions in AST-3, the IEA adopted a procedure which details the manner in which differences in import/export data between IEA countries are to be treated. This procedure provides that each country's data submission (Questionnaire B) is to be accepted as the best indicator of a country's supply position unless the difference is due to an identifiable error. Because of the increasingly larger share of international oil transactions subject to third party deals, as well as changes in ownership and ultimate destinations while oil is in transit, the cause of these data differences are not always easily identified. Thus, the U.S. experience with force majeure may have shown that the change in test procedure adopted following AST-3 may still not be totally sufficient for an international oil market where third party and oil trader transactions are so large and numerous.

Question 3: On the subject of preemption, didn't at least one State impose price and allocation controls during AST-4?

What would this Administration have done about that in a real situation?

Answer: No state actually "imposed" price and allocation controls during AST-4. California and Maine activated state set-asides. New York indicated that if this had been a real event the Governor would likely have declared a State of Energy Emergency, as authorized under paragraph 1, section 5-117, of the New York State Energy Law, and empowered the State's Energy Commission to "allocate available supplies of energy or energy resources..."

We believe that State and local governments should be free to develop their own approaches (and even to make their own mistakes), so long as they do not impermissibly impede interstate commerce or are not preempted by Federal laws or regulations.

Question 4a: Mr. Vaughan, is this Administration still opposed to including oil prices in the next AST-4 test?

Answer: The decision to oppose pricing in AST-4 was based upon a review of that particular test, particularly the lack of agreement on the pricing principle applicable to IEA allocation transactions. Although we opposed the inclusion of pricing in the international aspects of AST-4, the Administration was aware of and did not oppose the inclusion of prices for domestic purposes by three other IEA countries. Furthermore, the Administration did not rule out the possibility of including oil prices in future IEA allocation tests.

The U.S. is, of course, willing to work with the IEA in considering the feasibility and practicality of specific proposals for including price in future tests.

Question 4b: Wouldn't the inclusion of oil prices give you a better assessment of the extent we can rely on Non-Reporting Companies to offer to share oil in a real crisis?

Answer: It is not clear to what extent training exercises such as AST-4 can ever be used to predict real world events, e.g., the extent to which any particular participant can be relied upon to share oil in a real crisis. The decision to share oil will necessarily be based upon a number of commercial factors at the time of an actual emergency, such as the relative supply position of a company resulting from the emergency. It is not clear how useful the simulation of such commercial or other factors would be in providing reliable predictions for actual behavior in an emergency. A test can be helpful in assessing certain mechanics of sharing oil within the test parameters. In this connection, AST-4 was very helpful in pointing out the possibility that Non-Reporting Companies could be a significant source of oil in the event of an actual emergency to assist in meeting U.S. obligations under the Agreement on an International Energy Program.

Question 5: If one compares the section in S. 1678 on voluntary agreements and plans of action versus the similar provisions in existing law (Title 50, U.S. Code, Appendix on War and National Defense), one finds a number of safeguards not contained in S. 1678.

For example, in the Code to obtain immunity from the anti-trust laws requires a showing of "good faith" and a showing that the party in question actually complied with the voluntary agreement. There is an automatic expiration date of 2 years on all voluntary agreements.

Could you provide for the record which additional safeguards in existing law on voluntary agreements that you think should be included in S. 1678?

Answer: The proposed new authority for voluntary agreements and plans of action contained in S. 1678 is modelled after section 252 of the Energy Policy and Conservation Act (EPCA; 42 U.S.C. section 6201), which the Congress enacted in 1975 to provide for implementation of the Agreement on an International Energy Program, rather than after section 708 of the Defense Production Act of 1950 (DPA; 50 U.S.C. App. section 2158), to which the question alludes. These authorities provide a limited antitrust defense, subject to a number of conditions and safeguards, as distinguished from immunity.

Contrary to what is stated in the question, the proposed new section 274 of EPCA in fact would require a showing of compliance with the approved

A5 Continued voluntary agreement or plan of action; in this respect it follows the requirements of section 252. See proposed subsection 274(f)(1) and (2) and EPCA subsection 252(f)(1) and (2). Proposed subsection 274(f) does omit the language of EPCA subsection 252(f)(3), dealing with the burden of proof, and in the Administration's October 19 written report to the Committee on S. 1678, the recommendation is made that this provision be added to proposed subsection 274(f).

The unique, vague and difficult "good faith" test was added to the section 708 antitrust defense of the DPA in 1975; prior to that time, section 708 afforded complete antitrust immunity, which the President was given broad authority to convey. No comparable "good faith" requirement was imposed by the Congress in EPCA section 252.

Section 252 and the proposed section 274 of EPCA also omit the DPA section 708 provision for voluntary agreement expiration after two years (subject to indefinite two year extensions thereafter).

EPCA section 252 contains a number of antitrust protections, which have been incorporated into the proposed section 274. Full participation

A5 Continued by both the Justice Department and the Federal Trade Commission (FTC) is provided for, and no voluntary agreement or plan of action may be carried out unless approved by the Secretary of Energy and by the Attorney General, after he has consulted with the FTC. No meeting may be held to carry out a voluntary agreement or plan of action unless it is initiated and chaired by a regular full-time employee of the Department of Energy, and preceded by timely and adequate notice to the Justice Department and FTC. The Justice Department and the FTC may promulgate rules governing the maintenance of necessary and appropriate records, and may propose alternatives to voluntary agreements and plans of action to avoid or overcome possible anti-competitive effects. Subsection (d)(1) of the proposed section 274 says that the Attorney General "shall have the right to review, amend, modify, disapprove, or revoke" any voluntary agreement or plan of action.

In addition, the Administration's October 19 letter concerning S. 1678 notes that some limitation on the availability of proposed section 274 is called for. For example, it recommends making clear that the benefit of

A5 continued the antitrust defense would be enjoyed only when and to the extent that participants were carrying out tasks at the request of the President.

GROUP TWO

Question: From your testimony I take it that the Administration does not endorse S. 1678, or at least there are significant revisions that you would want to have incorporated. Is that correct?

Answer: The question does not fairly characterize the Administration's position on S. 1678.

DOE's letter of October 19 addressed to the Committee's Chairman presents the views of the Administration on S. 1678. This letter states that in general, the Administration "supports and encourages legislative efforts to address the energy emergency preparedness issues which are the subject of this bill." For example, the Administration "strongly supports" section 4 of the bill extending the Energy Policy and Conservation Act section 252 antitrust defense for U.S. company participation in implementation of the Agreement on an International Energy Program, and supports as well the bill's proposed amendments to section 252. The letter states that the Administration likewise supports the need for legislative action on the subjects of executive reserves and voluntary agreements and plans of action, and it expressly salutes section 3(a) of S. 1678 as an "important step" in providing the needed relief from conflict of interest and antitrust law impediments.

While it is true that the Administration has expressed some concerns about specific provisions of the bill and has endeavored to offer constructive suggestions for revisions, this is to be expected in the case of legislation dealing with a so broad a range of highly complex and technical issues.

GROUP THREE

QUESTIONS FROM SEN. BRADLEY FOR DOE ON AST-4

Question 1: Mr. Vaughan, in the AST-4 exercise you sent a message (number 0703) which stated that test participants can assume that appropriate economic response measures would have been implemented during the crisis. You said in message no. 0734, "Clearly, a policy decision of this nature would have been made by the President, with the advice of the Cabinet Council on Energy, the Congress, State officials and others...The economic response issue has been identified, and it should be assumed that the Administration, in consultation with the Congress and State officials, would certainly address this important matter." While the policy decision to implement an economic response could wait until a crisis struck, do you think we can also wait to develop a specific economic response measure? How long do you estimate it would take to fashion such an economic response measure, including legislation? What is your view on the need for such an option? What is DOE doing to develop a specific economic response package?

Answer: Because it is difficult to know what the size and nature of a potential future disruption will be or what economic conditions will prevail at the time, it would not be feasible (or desirable) to specify in advance precisely what economic response measures might be appropriate during a disruption. It is, however, prudent to have

1. Cont'd carefully considered what measures may be appropriate given possible ranges of economic conditions as a consequence of disruptions of varying sizes.

The selection and design of economic response measures require careful analysis of benefits and costs as well as specification of the procedures that would be used to implement the measures. DOE, working closely with other agencies, such as the Treasury Department, OMB, HHS, CEA, etc., plans to continue reviewing existing assistance programs to ensure that the Federal Government is prepared to respond appropriately to a severe energy supply disruption.

DOE has also identified for illustrative purposes different measures that the Federal government could initiate in response to a severe energy supply disruption. DOE has had materials prepared for two kinds of measures which deal with federal block grants and reductions in personal income tax liability. This planning details the steps that would be necessary to plan, implement, and phase out particular programs.

Question 2a: In his testimony on AST-4 before a House subcommittee Ron Winkler, your former deputy, said that he was unable to get interagency cooperation on addressing the formulation of an economic response to the disruption. Please tell us which agencies the DOE contacted on this matter and how each agency responded. For example, we understand that the Treasury department simply balked at believing that the price of oil reached $98 per barrel, that HHS said they were too short on personnel to respond, that the Council on Economic Advisers didn't have time to respond, and that OMB insisted on being only an observer and nothing more.

Answer: During AST-4, the DOE contacted the staff at five Federal agencies (Treasury, HHS, CEA, OMB, and Agriculture) asking, among other things, for information on actions taken or proposed in connection with economic response measures.

It should be noted that, during this same period, interagency coordination and review of a DOE draft report to the Congress entitled "The Domestic Impact of Reliance on Market Forces During a Substantial Petroleum Supply Disruption," was also underway. The report, which was submitted to the Congress on August 3 under the provisions of the Energy Emergency Preparedness Act of 1982, states Administration policy on this subject. Accordingly, it was not appropriate to simulate in AST-4 (which ended before submission of the August 3 report) economic response policies which were still under review at the time. The Department of Agriculture, which has an established emergency fuel assistance program, did simulate in AST-4 the implementation of its program.

A chronology of DOE contacts with the staff of the five Federal agencies is attached.

Attachment

DOE Contacts During AST-4 with Federal Agency Staff on Economic Response Measures

May 9, 1983: DOE contacted Treasury, HHS, CEA, OMB, and Agriculture requesting information on actions taken or proposed in connection with economic response measures.

May 12, 1983: Treasury was requested by DOE to provide, in addition to the above, an analysis of the U.S. economy and trade in light of the hypothetical disruption, as well as expected effects on Federal revenues and expenditures.

May 13, 1983: Agriculture reported, on the basis that farmer fuel supplies for planting were already located on farms, that total variable farm costs were estimated to rise by no more than 12 to 22 percent. Agriculture noted: "This level (of price increase) is not high enough to significantly alter farmers' production plans." Nevertheless, Agriculture reported that it had begun urging voluntary fuel conservation, had directed that monthly energy needs for agricultural production be provided to DOE, had reinstituted the Agricultural Stabilization and Conservation Service emergency fuel assistance program, and had reinstituted weekly monitoring of fuel adequacy.

May 17, 1983: DOE staff telephoned the remaining agencies and was advised by HHS, CEA, and OMB that they had no comments on the request; Treasury expressed concern that the dissemination of information on hypothetical economic response measures could mislead the public about responses in an actual emergency.

May 24, 1983: Treasury noted that it was only an observer of AST-4 activities.

Question 2(b): Do you think that our Nation should have an economic response package available for use in an energy disruption? What is the Administration's position on this issue? What do you see as the next step in working on an economic response package? What agency should take the lead on this?

Answer: The Administration position on this matter is clear: the Federal Government must be prepared to respond appropriately to the economic exigencies which may be created by a severe petroleum supply disruption. However, because it is impossible to know what the size and nature of a future disruption will be or what economic conditions will prevail at the time, it is not feasible (or desirable) to specify in advance precisely the fiscal or monetary policy measures that might be appropriate during a particular disruption.

DOE, working closely with other Federal agencies, has begun this planning process by identifying for illustrative purposes different measures that the Federal government could initiate in response to a severe energy supply disruption. DOE has had materials prepared for two kinds of measures which deal with federal block grants and reductions in personal income tax liability.

2(b) Cont'd: As noted in a previous response, the next step in this connection is to continue the review of existing programs.

Question 3: Mr. Vaughan, a Memorandum of May 25, 1983, to the Secretary, entitled, "Suspension of New Solicitations for Bids and Purchases of Oil for Filling the Strategic Petroleum Reserve" states in reference to deliveries of oil to the SPR under existing contracts, "We have been advised by the Office of General Counsel that cancellation of such shipments might require a Presidential drawdown decision, particularly if they are in transit, and if they were loaded FOB origin (meaning the United States took title at the time of loading)." In essence, the memo seems to say that during a disruption the only way to divert shipments of oil away from the SPR and to refineries where the oil can be used is for the President to declare a drawdown of the SPR. Is that correct?

Answer: When the question of diverting incoming SPR oil supplies arose in 1978 during the Iranian revolution, the then General Counsel of DOE advised that there was "substantial doubt as to DOE's authority to divert oil" to meet energy needs in the absence of a Presidential finding under section 161 of the Energy Policy and Conservation Act (EPCA) that drawdown was required by a "severe energy supply interruption" or to meet U.S. obligations under the International Energy Program (IEP). As was pointed out in the General Counsel's memorandum (copy enclosed), in the absence of extraordinary circumstances DOE lacks any usable authority for the cash sale (as distinguished from a time exchange) of oil to which it has taken title for purposes of SPR storage, unless the prescribed Presidential finding has been made.

It might be possible, depending on the circumstances, to release into the marketplace other oil which is under contract for delivery to the Government on an

A3 Cont'd f.o.b. destination basis, or which the Government has not yet lifted at the origin point.

The legality of diverting SPR oil prior to an SPR drawdown decision has been further complicated since 1978 by the various fill rate mandates enacted by the Congress, which may be difficult to reconcile with a pre-drawdown diversion of incoming SPR oil. Thus in the Energy Emergency Preparedness Act of 1982, Pub. L. 97-229, subsection 160(c)(1) of the EPCA was amended to require that if available appropriations are sufficient, the amount of petroleum in the SPR must be increased during a fiscal year by at least 300,000 barrels per day, or 220,000 barrels per day if the President has found that the 300,000 rate would not be in the national interest; and further, that to the extent that the available appropriations permit, the rate of increase "shall be the highest practicable fill rate achievable...." Earlier, in the 1980 Energy Security Act, Pub. L. 96-294, the Congress had added subsection 160(d) to EPCA, effectively requiring a shut-in of Naval Petroleum Reserve No. 1 at Elk Hills, California, unless SPR

A3 Cont'd

oil storage is being increased at a rate of at least 100,000 barrels per day for the fiscal year.

Subsection (e) of EPCA section 160 permits these fill mandates to be waived only in case of a declared SPR drawdown, or if the President transmits to Congress a finding that compliance with them significantly impairs U.S. ability to respond to a severe energy supply interruption or meet IEP obligations. Moreover, although the requirement for Congressional approval procedures which the subsection contains would appear to be unconstitutional in light of the Supreme Court's recent decision in I.N.S. v. Chadha, it would remain to be determined whether the Congressional approval provision is severable from the remainder of subsection (e). If not, the waiver provision itself would be invalid.

Enclosure

Department of Energy
Washington, D.C. 20461

NOV 15 1978

MEMORANDUM FOR ALVIN L. ALM
ASSISTANT SECRETARY FOR POLICY
AND EVALUATION

FROM: LYNN R. COLEMAN
GENERAL COUNSEL

SUBJECT: USE OF SPR OIL DURING IRANIAN
SUPPLY INTERRUPTION

The purpose of this memorandum is to recapitulate our advice on the legality of utilizing SPR oil during an Iranian supply interruption and on the permissible methodology for diverting SPR oil.

Background

Section 161 of the Energy Policy and Conservation Act (EPCA) provides as follows:

> Sec. 161.(a) The Administrator may drawdown and distribute the Reserve only in accordance with the provisions of this section.
>
> (b)... [N]o drawdown and distribution of the Reserve may be made except in accordance with the provisions of the Distribution Plan contained in the Strategic Petroleum Reserve Plan which has taken effect pursuant to section 159(a).
>
> * * * *
>
> (d)... [T]he Distribution Plan contained in the Strategic Petroleum Reserve Plan... may [not] be implemented, and no drawdown and distribution of the Reserve ... may be made, unless the President has found that implementation of ... such Distribution Plan is required by a severe energy supply interruption or by obligations of the United States under the international energy program.

> (e) The Administrator may, by rule, provide for the allocation of any petroleum product withdrawn from the Strategic Petroleum Reserve in amounts specified in (or determined in a manner prescribed by) such rules. Such price levels and allocation procedures shall be consistent with the attainment, to the maximum extent practicable, of the objectives specified in section 4(b)(1) of the Emergency Petroleum Allocation Act of 1973.

The term "severe energy supply interruption" is defined in §3(8) as a national energy supply shortage which the President determines:

> (A) is, or is likely to be, of significant scope and duration, and of an emergency nature;
>
> (B) may cause major adverse impact on national safety or the national economy; and
>
> (C) results, or is likely to result, from an interruption in the supply of imported petroleum products, or from sabotage or an act of God.

The SPR's basic authorities are granted "to the extent necessary or appropriate to implement" the SPR Plan. §159(f)(A). The SPR Plan is required to include "a Distribution Plan setting forth the method of drawdown and distribution of the Reserve." §154(e)(12).

Discussion

1. SPR Drawdown and Distribution.

In the event the President finds that a "severe energy supply interruption" has occurred, all oil that is "stored" in the SPR can be drawn down and distributed. Since there presently is no operational withdrawal capability at the SPR storage sites, a drawdown would affect immediately only oil that is in transit to the sites or under contract. The EPCA does not specify how to treat oil which is not yet stored, but it would seem unobjectionable to draw down and distribute it pursuant the the same system used for stored oil.

DOE contingency planning has contemplated that if a Presidential drawdown decision were made in the near term, SPR oil would be distributed pursuant to DOE's Standby Crude Oil Allocation Regulations under §4(a) of the Emergency Petroleum Allocation Act, which are in draft form. EPCA §161(e) would be invoked as a basis for feeding SPR oil into the overall allocation system. As drafted, the Standby regulations in effect provide that such quantities of SPR oil as DOE may make available for allocation in this manner will be allocated to eligible purchasers, at a price and on terms and conditions, and pursuant to procedures, determined by DOE.

However, the contractual issues attendant to such a procedure have not yet been addressed. No procedures exist for the selection of purchasers of SPR oil; no contracts of sale exist; no internal DOE oil sale bureaucracy has been organized; and no pricing formula has been adopted to fix a base price or to adjust it for a variety of transportation costs and places of sale.

Alternative methods of utilizing SPR oil could be employed. Regardless whether or not the Standby regulations are adopted, there appears to be nothing to prevent promulgation, under EPCA §161(e), of an emergency regulation establishing a competitive sale or "auction" system as a means of "allocating" SPR oil. This could be the sole or a supplementary device for allocating SPR oil. The sale or auction format could be designed to accomodate differences in the place of delivery. Of course, contractual documents remain to be developed for these sale and auction mechanisms also.

A further obstacle to SPR drawdown at this time is the fact that the SPR Plan lacks the details of any allocation system which might now be adopted for SPR drawdown and distribution. The possibility of utilizing the Standby Crude Oil Allocation Regulations for SPR drawdown is disclosed in the SPR Plan only in the form of an "informational" appendix to Amendment No. 2, which expressly states that "No formal plans for DOE commitments of any kind should be inferred from it." Consequently, since drawdown and distribution must be in accordance with the provisions of the Distribution Plan contained in the SPR Plan, the SPR Plan should be amended to reflect DOE's intentions.

2. Absence of SPR Drawdown and Distribution.

a. Legal Authority.

In the absence of a Presidential determination triggering SPR drawdown and distribution, there still would appear to be a valid basis for diverting much of the oil now under contract for the SPR. However, the limitations on and rationale for such diversion should be understood.

The question of whether SPR oil may be utilized in the absence of a Presidential determination that a "severe energy supply interruption" exists (or to meet IEP obligations), was addressed twice previously, in the context of FEA planning to meet winter energy emergency requirements, and with respect to the needs of CORCO for crude oil supplies to satisfy Puerto Rico's product requirements. As we advised then, it would not seem proper to circumvent the clear Congressional intention as to the circumstances under which SPR oil is to be drawn down and distributed.

Moreover, there is substantial doubt as to DOE's authority to divert oil for the purpose of meeting energy needs falling short of a "severe energy supply interruption." DOE's authority to exchange SPR oil is limited by EPCA §160(a) to those exchanges executed "for purposes of implementing the Strategic Petroleum Reserve Plan" and by §159(f)(E) to exchanges for the acquisition of oil for SPR storage. No authority has been identified for the cash sale of SPR oil other than during drawdown and distribution, except as surplus Government personal property and pursuant to the cumbersome procedures therefor: with a delegation of authority from GSA, DOE could dispose of surplus oil, in accordance with prescribed procedures, through formally advertised competitive bidding or "auction," or by negotiated sale if a proper determination such as "public exigency" were made. See 40 U.S.C. §484. Unilateral partial or complete "termination for convenience" of outstanding oil purchase contracts could damage the SPR's credibility in the oil market.

Nonetheless, there does appear to be a valid programmatic reason for disposing of at least a substantial portion of the oil now under contract for the SPR, since oil purchases are well in excess of the SPR's fill capability, and significant demurrage and temporary storage costs are being incurred. This could be done through time exchanges or delivery deferrals in the manner discussed below, conducted for the valid statutory purpose of acquiring oil for later SPR fill.

Absent a Presidential determination instigating SPR drawdown and distribution, there would not be a basis for diverting all oil under contract for the SPR and indefinitely postponing SPR fill. However, EPCA §160(b) does direct the Secretary, "to the gratest extent practicable," to acquire oil for the SPR in accordance with certain objectives, including "(4) minimization of the impact of such acquisition upon supply levels and market forces." Thus if there is a reasonable basis for the Secretary to conclude that the SPR's oil purchases are so adversely impacting supply levels and market forces as to necessitate a suspension of SPR fill activity, then in our opinion it would be defensible to proceed with exchanges and related contractual actions temporarily, with respect to any oil now under contract for the SPR.

The EPCA neither expressly authorizes nor in any way precludes attempts to direct crude oil that is excess to the SPR's needs, or the immediate purchase of which DOE has decided to forego because of market considerations, to the U.S. market or to a friendly ally. Some authority to divert to the U.S., SPR oil that is in transit or under contract, can be inferred from the EPCA §160(b) requirement that, to the greatest extent practicable, oil for the SPR be acquired in a manner consonant with "(3) minimization of the Nation's vulnerability to a severe energy supply interruption" (emphasis added). Justification of an attempt to divert such oil to a friendly ally would derive from the inherent foreign policy powers of the President.

b. Methodology.

Available crude oil could be diverted from the SPR in various ways, including time exchanges and negotiated deferrals of delivery.

DOE's oil purchase agent, the Defense Fuel Supply Center (DFSC), is developing a contractual structure for oil exchanges. As envisioned this would involve the award to all interested and responsible firms of non-contractual frameworks for contracting, denominated "Basic Exchange Agreements" (based on the "Basic Ordering Agreements" provided for in the Federal Procurement Regulations). The Basic Exchange Agreements would set out insofar as possible the contractual provisions to apply between the parties in the event an exchange contract was awarded. As needs for exchanges arose, firms with which the Government had Basic Exchange Agreements would be invited to offer in accordance with the Government's stated requirements, and award would be made to firms offering terms most advantageous to the Government, considering such factors as the oil exchange ratio. Firms could be required to agree that the crude oil and/or product derived therefrom would be delivered into the U.S.

From the time DOE authorizes DFSC to proceed, it will take several weeks to put this system in place. In the interim, any necessary exchanges might have to be effectuated by DOE. This would be difficult and would entail considerable risk, however, because DOE personnel are comparatively inexperienced in oil trading, DOE is not staffed or organized to conduct such trading, and it would be impossible, in expedited transactions involving limited competition, to assure that the Government had obtained the most advantageous financial terms.

An alternative would be to contract with suppliers for deferral of deliveries; a deferral in essence is a time exchange with an existing supplier. Deferrals may be essential in some cases in any event, in order that DOE may avoid losing its rights to delivery of contracted-for oil. Under DFSC's standard crude oil purchase contract, specified quantities of oil are deliverable each month, ratably over the month; DOE must order against deliveries twenty days in advance or lose its rights to the ratable quantity of oil. Having placed an order, DOE must lift the oil or lose its rights to it. Since DOE has not arranged to lift all cargoes, the lifting of which has or will shortly come due, the supplier could refuse to provide oil as to which DOE had lost its rights. In such cases a deferral agreement may be the only solution.

Deferral of November-December 1978 deliveries into early 1979 could result in SPR supplies being available to offset the impact of an Iranian supply interruption. The terms of any deferrals, including the question of barrel-for-barrel exchanges so that DOE is not impacted by an OPEC price increase, would be negotiated by DFSC, separately for each contractual situation.

In addition, DFSC could attempt to assure, through a written and potentially public statement of the contractor, that in the event of deferral the supplier would deliver into the U.S. market an incremental quantity of oil equivalent to that deferred.

cc: Deputy Secretary

Question 4: Given that the President's declaration of an SPR drawdown is a very significant decision, might not the President be reluctant to declare a drawdown just to achieve a diversion of oil destined for delivery to the SPR? This appeared to be the case in AST-4. Would it be useful for the President to have new, distinct authority in an oil supply emergency to sell and divert shipments of oil destined for the SPR without affecting any SPR oil actually in storage? This would afford the President the opportunity to take limited action to address an oil supply disruption without incurring all the ramifications of an SPR oil drawdown.

Answer: Decisions taken in the artificial environment of a test exercise do not justify a conclusion that the requirement for a finding of a "severe energy supply interruption" would inhibit a drawdown decision for purposes of attempting to divert incoming SPR oil in a real emergency.

We are not prepared to take a position at this time on legislation giving the President greater discretion to reduce or halt SPR fill and sell some SPR oil, prior to making a finding of a "severe energy supply interruption." However, it should be recognized that such legislation would be of only limited utility if it did not address the interconnected issue of SPR fill rate requirements. But as explained in response to the preceding question, even with appropriate legal authority, the concept of SPR oil diversion could be difficult to implement, except insofar as it proved feasible for the Government first to take title to oil bought for the SPR, and then to offer it for sale or time exchange.

Question 3: How much oil is moving through the Strait of Hormuz. As a percentage of world oil demand? As a percentage of U.S. oil imports?

Answer: Based on preliminary data, the August 1983 volume of oil moving through the Strait of Hormuz is estimated to be about 10 MMB/D. This represents about 20 percent of estimated current oil demand of the free world economies. Preliminary August data indicate that about 12 percent of U.S. oil imports (on a 50-State basis) or about 5 percent of U.S. consumption passed through the Strait.

Question 4: How much of the world's surplus oil production capacity would have to move through the Strait of Hormuz, if produced?

Answer: The level of unused oil production capacity worldwide was estimated in August to be in the range of 11 MMB/D to 13 MMB/D. Of this total, about 70 percent is located in the Persian/Arabian Gulf region. It is likely that all but about 1.5 million barrels per day of potential additional production from the Gulf region would have to transit the Strait of Hormuz, if produced.

Question 5: What do you think would happen to oil prices if Iran halted ship traffic through the Straits of Hormuz?

Answer: As a broad generalization, a sustained halting of oil tanker traffic through the Strait of Hormuz would cause world oil prices to increase. It must be borne in mind, however, that the effect on oil prices would be determined primarily by expectations of the duration of the interruption and the net effect on world oil supplies; that these expectations would be affected by the specific events causing the disruption; and that the net effect on supplies also would depend upon government and private inventory use worldwide during the interruption and the degree to which other countries have excess production capacity and increase their oil and gas production to offset the loss in world supplies.

Question 8: The new section 274 of EPCA, entitled "Voluntary Agreements and Plans of Action for Energy Emergencies", employs almost verbatim the language which is in Sec. 252 of EPCA regarding International Voluntary Agreements.

Under that section of EPCA, voluntary agreements and plans of action may be used *only* for implementing the international *allocation* program and the IEA *information* program.

What do you need this language for if you want a free market?

Answer: The Administration is strongly committed to utilizing the assistance of the private sector in domestic and international energy emergencies in order to meet both defense-related and non-defense-related needs. The Federal Government could never maintain, on a continuing basis, sufficient personnel with adequate expertise to be able to respond as needed to a wide range of potential energy emergency situations. Even if such persons were hired initially, very quickly they would lose their level of expertise by virtue of being out of the actual energy business.

On the other hand, in the private sector the United States has extensive expertise in a wide range of energy operational matters. The Administration wants to be sure that existing conflict of interest and antitrust laws do not serve as a substantial deterrent to private sector involvement in the Government's efforts to deal with energy emergencies

A8 Continued

with the result that the Federal Government would be unable to avail itself fully of this pool of talent. A reason is that industry, whether correctly or not, has a strong apprehension that good faith actions taken by participants in an effort to assist the Federal Government in dealing with actual or prospective energy emergencies may result in civil or criminal litigation, or even in liability. Whether this apprehension is justified or not, these laws should not preclude the United States from having the capability to respond as well as it might to future energy supply disruptions that may occur.

Section 252 provides a useful model for a new antitrust defense because it is an actively implemented authority. Proposed section 274 would be available to permit the utilization of the private sector for purposes other than allocation, and programs other than those of the IEA. For example, voluntary agreement participants could undertake market analyses, recommend emergency preparedness actions, expedite energy supply transportation, etc.

A8 Continued The new antitrust defense would facilitate preparation for, or responses to, domestic or international energy emergencies. It would be available with respect to defense or non-defense emergencies. It potentially could cover efforts to meet (non-IEA-related) international obligations of the U.S. such as those with respect to the NATO Wartime Oil Organization and the U.S.-Israeli supply agreement, for which no antitrust protection presently exists.

Department of Energy
Washington, D.C. 20585

November 23, 1983

Mr. Mike Harvey
Chief Counsel for Minority
Committee on Energy and
  Natural Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Harvey:

On October 19, 1983 Assistant Secretary William A. Vaughan appeared before the Committee on Energy and Natural Resources to discuss S. 1678, Energy Emergency Preparedness Act Amendments of 1983.

Following that hearing, you submitted written questions for his response. Enclosed are the answers to those questions.

If you have any questions, please call Diana Diamond or Tom Pretorius of my staff on 252-4277. They will be happy to assist you.

Sincerely,

Thomas H. Pretorius
for Robert G. Rabben
Assistant General Counsel
for Legislation

Enclosure

cc: Mr. Al Astrin
    Committee Staff

Question 1: We understand that the API has recommended in a letter of October 27, 1983, to the Energy Information Administration that "EIA eliminate the EP-51 and rely on customs data". Apparently, the API has concluded that the existing customs data from Form 7501 is adequate to satisfy DOE requirements and that EIA should eliminate Form EP-51.

Has API made such a recommendation?

Answer: API has recommended that the EIA eliminate the Form EP-51. A copy of the letter from API to the EIA (and EIA's response) is attached.

Question 2: What are the differences between the types, quality, and timeliness of information collected under these two forms?

Answer: The basic difference between the Customs data and the EP-51 data is that the EP-51 primarily measures individual cargoes at the time of original purchase rather than at the time they pass through U.S. Customs. Since many crude oil ships do not offload directly into U.S. ports (they either pass through transshipment or "Lighter" onto smaller vessels) it has proven to be very difficult in the past for companies to report the kind of detail requested in the EP-51 on a landed or Customs basis.

Over the past eighteen months or so, EIA has studied the relative merits of merging the Form EP-51 with the other imports data it now collects, and of replacing it with the Customs data. It is our understanding that, based on the analysis that EIA has performed, the Customs data are not of adequate quality to replace the EP-51, even for those items in which there is a clear overlap of data elements. EIA found, for example, that different Customs ports do not maintain the same standards for submitting invoices and that substantial corrections are submitted as late as six months after the original data are reported. Additionally, there are a number of data elements such as the type of crude (for example "Bonny Light") that are not now collected in the Customs system.

Question 3: What is the position of the Department with respect to the abolition of Form EP-51?

Answer: The position of the Department from our perspective is that the Form EP-51 should be retained as an EIA data collection. Beside the data problems mentioned above, in switching to sole reliance on Customs data, the annual cost to the Department of modifying and maintaining the "PILAS" system, which currently utilizes Customs data, would be on the order of $300,000-500,000, while the Form EP-51 costs less than $150,000 per year to operate.

Question 4: If the form is eliminated what will be the effect on the ability of the Department to meet its EIA information obligations and to monitor international and domestic crude markets and the supply and the price of oil in such markets?

Answer: If the form is eliminated the overall quality and level of detail of certified company data on crude oil prices will be reduced. The Department's ability to report to the IEA, for example, will be compromised, especially with the loss of the type of crude oil data element. While the API has pointed out that this item and others (such as type of transaction) are available on the original invoices which Customs theoretically requires, it has not indicated in its letters or in the workshops conducted in cooperation with the EIA how such information would be forwarded to the DOE by Customs. Therefore, from both a practical and technical point of view, our ability to monitor oil markets for reporting to the IEA would be severely limited.

Question 5: Is the information collected in Form EP-51 used by any other agencies? What agencies are involved and for what purposes is this information used in those agencies?

Answer: It is our understanding that the Bureau of Labor Statistics also uses the Form EP-51 data to publish an index of crude oil costs which is consistent with its other data. Detail by type of crude oil are required to calculate an index, since the "market basket" of crude oils is held constant in their statistical methodology.

NOV 15 1983

Mr. Edward H. Murphy
Director of Statistics
American Petroleum Institute
1220 L Street Northwest
Washington, D.C. 20005

Dear Mr. Murphy:

From the comments in your October 27, 1983 letter on issues associated with the EP-51 form, "Foreign Crude Oil Transaction Report," I am surprised to see that our positions are so far apart. You will recall that, in response to industry suggestions, we expended substantial amounts of funds, energy, and time evaluating all of our imports reporting systems. This included a December 1982 conference that described the needs of market analysts in the International Energy Agency (IEA), various parts of the Department of Energy (DOE), and in the petroleum industry in general.

A reporters' conference followed in February, where we presented a concept for forms consolidation in order to focus discussion specifically on data availability, reporting burden, and costs. Your staff will remember that industry reporters' response was such that our original agenda, in which we intended to discuss intracorporate transfer prices and foreign/domestic affiliate relationships, was never completed. Rather, by mutual agreement, we gave up the notion of consolidating imports systems. At that point, we already had expended one to two person years of in-house time and $50,000 of contractual support on the effort.

Following that, numerous meetings and conversations were held to resolve outstanding issues on the EP-51 foreign oil acquisition form. Miriam Yazge's September 2 letter notwithstanding, as late as two weeks ago, I thought the only remaining point of disagreement was the degree of accuracy we would require of international, integrated U.S. corporations' reports of acquisition prices for crude oil obtained from unaffiliated companies. Therefore, it is disappointing to see that you have returned to the point we started from 18 months ago.

Regarding the technical comments in your letter, it is understandable that there may be some confusion remaining on your part about what is required to assess international crude markets because the subject is quite complex. Although I think that John Cook's

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correspondence with Miriam in response to the letter that I referenced earlier amply describes our requirements for accurate arms-length purchase data, comments are enclosed for additional background and clarification.

Finally, I think there is a great deal of misunderstanding about the issue of reporting third party purchase transactions. We have been informed by your companies that the intracorporate transfer prices are usually close to the companies' actual acquisition costs. We would like them to report the actual acquisition costs in these transactions according to their best estimate at the time the EP-51 is filed. If the estimate is subsequently found to be in error by more than three percent, it must be resubmitted. Although we would like the companies to report actual purchase costs for arms length acquisitions, in certain situations a transfer price could represent their best (available) estimate of cost for a crude cargo.

During the regulatory era, EIA relied on the ERA-51 system for prices in order to avoid imposing an additional reporting burden on the industry. After decontrol, we sought to streamline the system consistent with our requirements and our evolving knowledge of company reporting practices. While we have known for some time that the transfer prices reported by some companies are inappropriate for the needs of data users, we have delayed making changes to some of the reporting instructions until we conducted a thorough review of all our imports systems and could implement all changes at once. Therefore, it is incorrect to imply that we have found transfer prices acceptable previously.

Conversations with industry officials indicate that the data flow in the companies are probably incumbered by the complex tracking required by the Transfer Pricing Program. Although the international arms of some companies customarily have available the purchase costs of every cargo, the EP-51 data are generally reported by the domestic affiliates. This procedure may be more responsible for inducing burden than any requirement EIA imposes.

During the year and one-half that EIA has controlled the EP-51 system, the user list has grown considerably. Currently, we are responding to at least two major data requests per month from offices outside EIA, and from other Federal agencies. Given these needs, as well as those of Congress, the Strategic Petroleum Reserve and the IEA, it follows that elimination of the form is not a viable option. If additional discussions will serve to reduce the concern you expressed, my staff and I are available at your convenience.

Sincerely,

Jimmie L. Petersen

Jimmie L. Petersen
Director
Office of Oil and Gas
Energy Information Administration

Enclosure

Enclosure

The comments below may serve to clarify misunderstandings about EIA's use of Customs and EP-51 data:

- Government analysts throughout the DOE and other agencies use the EP-51 data as an historical record of market trends. As such, it should provide a record by which to judge more current, but incomplete and/or less accurate sources such as the trade press and Crude Watch. It is incorrect to assume that we, or other EP-51 data users, employ the EP-51 data to "track" spot prices, or to "uncover" market weaknesses.

- The large companies that terminal and transship through the Caribbean cannot track a landed cargo back to the original purchase transaction. Therefore, they report to Customs the date of shipment from the transshipment point and the crude oil's official sales price (OSP). We displayed at the imports conferences the distortions this causes in the historical "record". It is the timing problems resident in landed basis reporting that concerns us, not the timeliness of the EP-51 data; we already depend on other sources for more timely information.

- Customs seeks the price paid for a cargo in the transaction between a U.S. company and a foreign entity, but our investigation indicates that the extent to which this is pursued varies from agent to agent, and even cargo to cargo. Although Customs now requires invoices to support prices on the CF-7501, the "invoices" filed by some of the larger companies are letters of agreement between two parts of the same company, and the price reported is simply a transfer price, usually set very close to the OSP. Although this is an acceptable way of reporting foreign equity production, Customs agents abilities to distinguish third party purchases is limited if a company files all CF-7501s as intracorporate transfers. Since these companies usually report intracorporate transfer prices on the EP-51 also, it would not be surprising to see that both systems agree fairly closely. Thus, even though Customs' requirements are more stringent than EIA's would be under the proposed changes to the EP-51, Customs' enforcement of their reporting requirements probably is restricted by the reporting practices of the companies.

- The Customs data EIA now obtains must be improved substantially before it would be useful to EIA. The data are keyed at the ports by Customs employees, then transmitted electronically to Washington; for this service, EIA pays several hundred thousand dollars a year. However, the transmitted data are frequently incorrect and sometimes quite late. Editing and followup with customs field offices takes several weeks, and the resolution is not always complete. In addition to these problems, the data now being keyed must be augmented before EIA can satisfy its user requirements (e.g., crude stream must be added). At some point in the future, the state of EIA's Customs data may permit elimination of landed data from the EP-51 form.

American Petroleum Institute
1220 L Street, Northwest
Washington, D.C. 20005
202-682-8000

October 27, 1983

Mr. Jimmie L. Petersen, Director
Office of Oil and Gas
Department of Energy
Energy Information Administration
Forrestal Building
1000 Independence Avenue, S.W.
Room 2H058
Washington, D.C. 20461

Dear Mr. Petersen:

As we discussed, the Committee on Energy Reporting has carefully considered the nature and uses of the information reported on the EP 51. As you know, this report was originally instituted as a means of tracking petroleum transfer prices to insure compliance with the price control regulations then in effect. Since the elimination of these price controls, the need for this report has become questionable and the uses to which it is, or could be put, unclear. Because these uses have never been clearly defined, it is difficult for our member companies to understand the reasons for the changes being considered by EIA.

We are concerned that EIA apparently desires to change the nature of this report from a transfer price report to a much more burdensome and detailed report requiring tracking of intracompany transactions. If the continuation of this report can be justified, we strongly urge that the transfer price concept that was adequate in the past should not be altered.

Your staff has, in the past, indicated an interest in tracking spot oil prices in order to uncover any softening or firming in the petroleum market. As I'm sure you know, there is a substantial amount of fluctuation in spot prices making them a very poor indicator of future contract prices. Moreover, the data reported on the EP 51 is between 30 and 60 days late, making it a very poor source of current pricing information. The EP 51 thus is not a proper mechanism for tracking spot prices. If this is the objective you have in mind we would be most willing to work with you on identifying a more timely and efficient source.

Our companies have closely examined their reporting on the Customs Form 7501. In addition, we have discussed this reporting with the brokers and customs import specialists in the major ports. We have found that the Customs data is consistent with the information filed on the ERA 60 and the EP 51. Monthly differences between them are related to timing, lightering and transshipment. Moreover the Customs data is accurate and consistently reported throughout the country.

Our companies are presently studying the timing of their reporting on the Customs Form 7501, the EP 51 and the ERA 60. While I will be able to provide more specific data in several weeks it appears that, on average, a given cargo is reported earlier on the 7501 than on either the ERA 60 or the EP 51.

Based on our evaluation, we believe that the existing EP 51 is burdensome and unnecessary. Equally accurate and more timely information could be easily obtained from the Customs Form 7501. For this reason we strongly recommend that EIA eliminate the EP 51 and rely on the Customs data.

We would, of course, be pleased to meet with you and discuss any impediments to eliminating this report.

Sincerely,

Edward H. Murphy
Director of Statistics

United States Department of State

Washington, D.C. 20520

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WASHINGTON, D.C. 20510

Official Committee File
NOV [illegible] Richard

Dear Mr. Chairman:

I have enclosed our responses to questions sent by your letter of October 24, 1983. The Department of Energy will respond to your other questions separately.

The Office of Management and Budget advises that from the standpoint of the Administration's program there is no objection to the submission of this report.

Sincerely,

Alvin Paul Drischler
Acting Assistant Secretary
Legislative and Intergovernmental Affairs

Enclosure:

Responses.

The Honorable
James A. McClure, Chairman,
Committee On Energy And Natural Resources,
United States Senate.

Answers to
Questions Submitted by the Minority
For the Departments of State and Energy

1) Q: The Washington Post yesterday carried an article entitled "Shultz criticizes Iran's threat to close Persian Gulf to oil ships".

The gist of the article appears to be that Secretary Shultz doesn't want Iran or anyone else using a threat to close the Straits of Hormuz as leverage to gain concessions from their opponents.

Is Iran capable of closing the Straits of Hormuz, if they desired? Is this an idle threat?

A: As noted in a previous answer, it has been speculated that Iran could interfere with neutral shipping through the Strait of Hormuz; however, any restriction on freedom of navigation and access to Gulf oil supplies would be a matter of serious concern to the international community.

2) Q: Would Iran have to do more than simply use enough force to convince the insurers (Lloyd's of London) of oil tankers that the Straits of Hormuz is a war risk zone so that they would notify shippers that their insurance is void in that area?

How much activity would be necessary to temporarily halt ship traffic through the Straits?

What options would we have as a response?

Could we use military escorts and, if so, who would insure the tankers?

A: The high insurance premiums which prevailed early in the 1980-81 Iran-Iraq war were not enough to make Gulf oil unprofitable. As in the previous conflict situation, insurers would probably continue to write policies for shipping there, although at higher premiums and producers might well reduce prices as in 1980 and 1981 to compensate for the higher rates. The response of tanker crews to hostilities, whether or not the area had been officially declared a war zone, is another factor which is difficult to predict.

It has been speculated that Iran could attempt to interfere with shipping through the Strait of Hormuz in various ways, such as the laying of mines, stop and search operations, or the imposition of a full or partial ban on shipping through the Strait; however, it is impossible to predict how shippers would respond to any of these measures.

Our response would depend on the nature of the measures taken by Iran and on the threat they would pose to freedom of navigation and access to oil supplies. We cannot predict the actions of insurance firms in the event of this or any other hypothetical action.

6) Q: How long do you think this threat will loom over the Strait of Hormuz?

A: Given the strategic and economic importance of the Persian Gulf and the history of political tensions originating within and outside the region, the threat of a disruption of Gulf oil supplies is an ongoing one. Recent threats by both Iran and Iraq to widen the war in the Persian Gulf in ways that would restrict oil exports have made this problem all the more clear. We have therefore reinforced, publicly and in diplomatic channels, our concern regarding any action that would jeopardize freedom of navigation and access to oil in the Gulf. We continue to cooperate with all parties interested in restoring peace to the region, but we cannot predict when the war, which has been so costly to both sides, will come to an end.

7) Q: Without getting into sensitive matters, are there any other vulnerable points for us besides the Straits of Hormuz, such as Saudi oil installations?

A: Of course, it is impossible to specify precisely where difficulties might occur but we can say that wherever we find high capacity facilities in a limited geographic area that is subject to violent political conflict, vulnerable points exist.

Answers to
Questions Submitted by the Minority
For the Department of State

1) Q: On page 5 of your statement you said that, "The test cannot tell us, for example, whether we should or should not have drawn down the SPR or should have used a system of fair sharing among U.S. companies."

Doesn't the test tell you that if large U.S. oil companies are going to be expected to participate in the voluntary allocation program then either a "fair sharing" program or SPR drawdown will be necessary to induce them to participate?

A: AST-4 itself did not conclusively demonstrate the necessity or lack of necessity for fair sharing. Nor was it intended to do so. It was designed to test procedures and train personnel, not evaluate market behavior in a crisis or policy. Participants in any IEA test are likely to behave differently in the test than they would in a real crisis, which makes it difficult to draw policy conclusions.

It is true, however, that a majority of the IEA reporting companies have taken the position repeatedly that they would need some kind of fair sharing to participate voluntarily in the IEA sharing system during a crisis. One of the options identified in AST-4 was the drawdown of the SPR so that companies which successfully bid on SPR oil would be encouraged to make voluntary offers (with the additional option of directing up to 10% of the volumes drawn down to specific companies).

2) Q: On page 6 of your statement you say that you reaffirmed our commitment to the fulfillment of IEA obligations in a major supply disruption "by reliance on market forces reinforced, if necessary, by supplemental methods such as SPR drawdown." Is this Administration taking a rigid view that under no circumstances would they resort to mandatory measures in order to achieve our IEA obligations or are you including the possibility of mandatory programs under the term "supplemental methods".

A: The Administration is committed to meeting our IEA obligations. It is our view that mandatory measures would not be necessary for the U.S. to meet its commitments in a crisis; however, the U.S. has authority to meet its IEA commitments by use of certain mandatory measures, and will use the appropriate authorities if necessary.

U.S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

15 FEB 1984

Honorable James McClure
Chairman, Committee on Energy
and Natural Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This letter formally transmits to the Committee the responses to the questions on the Administration's testimony on S. 1678 that were enclosed in your letter of October 24, 1983 to Attorney General Smith. Our correspondence to you of February 6, 1984 sets forth in detail our position on S. 1678.

Question 1: You have examined S. 1678 carefully, haven't you, with respect to the antitrust issues in it? Did anyone in the Justice Department prepare a memorandum commenting on this bill? Was it circulated to any other agency? Who? Did it express any concerns about the antitrust aspects of S. 1678, other than the concerns expressed in your testimony cleared by OMB? Could you make that memorandum available to the Committee?

Answer: The Department of Justice has examined S. 1678 carefully with respect to antitrust issues, and we have submitted a report expressing our views of the bill, including our concerns about the antitrust and conflict-of-interest provisions of S. 1678. The report received approval through the Administration's clearance process of the Office of Management and Budget.

Question 2: You have reviewed S. 1678 in particular with regard to the antitrust provisions, have you not? Are you comfortable with the breadth of the antitrust and conflict-of-interest immunities in this bill?

Answer: The Department has reviewed S. 1678 with regard to both the antitrust and the conflict-of-interest provisions. We are not comfortable with the breadth of the immunities and defenses provided from the antitrust and conflict-of-interest laws by those provisions. Our views, which are consistent with the prepared statement of Assistant Secretary Vaughan, are fully explained in our report of February 6, 1984.

Question 3: Would you please explain why you did not attend the hearing which you were requested to attend on emergency preparedness on October 19, 1983, before the Senate Committee on Energy and Natural Resources? When did you communicate to the Committee that you would not attend? Who made this communication and how did they make this communication?

Answer: The Administration's position on the provisions of concern to this Department, specifically those sections of S. 1678 relating to the conflict-of-interest and antitrust laws, was still under review during the week prior to the hearing. It did not appear that a position would be developed by the day of the hearing. Until the position was finalized, we did not believe it appropriate to appear at the hearing since all we could have stated was that the issues were under review. While Assistant Secretary Vaughan did set forth in his prepared statement the Administration's position, the matter was not finalized until just prior to the hearing.

The Department's Office of Legislative Affairs notified Mr. Grundy of the Committee's staff by telephone on October 14, 1983, that a representative would not appear at the hearing.

We hope that this letter and our report of February 6, 1984 is responsive to the Committee's inquiries.

Sincerely,

(Signed) Robert A. McConnell

ROBERT A. McCONNELL
Assistant Attorney General

APPENDIX III

Additional Department of Energy and Department of Justice Comments on S. 1678

Department of Energy
Washington, D.C. 20585

February 3, 1984

Honorable James A. McClure
Chairman
Committee on Energy and Natural
Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In Assistant Secretary Vaughan's letter to you of October 19, 1983, the views of the Administration were presented on S. 1678, the "Energy Emergency Preparedness Act Amendments of 1983," which is pending before the Senate Committee on Energy and Natural Resources. As you know, S. 1678 would amend the energy emergency authorities in the Energy Policy and Conservation Act (EPCA), Pub. L. No. 94-163, and the Energy Emergency Preparedness Act of 1982 (EEPA), Pub. L. No. 97-229, to (1) assure the availability and effectiveness of the energy emergency executive reserves and voluntary agreements in energy emergencies, (2) require an average fill rate of the Strategic Petroleum Reserve (SPR) of at least 145,000 barrels per day, (3) extend the antitrust defense for U.S. oil companies participating in the International Energy Program until June 30, 1985, (4) permit the Federal Government to preempt the operation of any state or local law dealing with the pricing or allocation of petroleum products, and (5) require reports to Congress on a number of emergency preparedness issues.

The October 19 letter made clear that, in general, the Administration supports and encourages legislative efforts to address the energy emergency preparedness issues which are the subject of S. 1678. However, we believe that a number of changes are needed in the bill to narrow or perfect certain of its provisions. Accompanying this letter is a copy of S. 1678 which we have altered to show our proposed revisions. With these changes, the Administration will be able to give its full support to this bill.

The Administration's proposed amendments to S. 1678 are as follows:

Section 2, Findings and Purposes

This section needs to reflect more accurately the policy of primary reliance upon the free market that the bill is directed at supporting, and to characterize better the circumstances under which private sector organizations might be utilized to deal with energy emergencies. Accordingly, our proposed amendments of section 2(a)(2) would make clear that not only State and local but also Federal pricing and allocation could frustrate free market policies; our amendments also would place less emphasis on Federal Government intervention in markets. Related changes would be made in sections 2(b)(1)(D), 6(b)(3) and 6(b)(4) of the bill.

Our changes in sections 2(a)(1) and 2(b) of the bill would rephrase the needed actions in terms of a continuation of ongoing Administration efforts.

Also, we believe the Congress should make clear its intention that private sector organizations would be activated to deal only with truly national or international, rather than purely local emergencies. This intention is better indicated in the bill by referring, in section 2(b)(1)(B), to the use of such organizations in "energy emergencies of national or international character in order to meet defense-related or non-defense-related needs". To carry this concept through in subsequent provisions of the bill, similar amendments are proposed elsewhere: in new EPCA sections 274(a) and (d)(2), this language is employed to describe the kind of emergency which would warrant the use of voluntary agreements and plans of action; where proposed sections 273(a)(4) and (c)(1) and section 274(c)(1)(B) refer to a Presidential finding that "the national interest" requires exercise of the authority contained therein, a reference has been substituted to "achievement of the purpose described in section 2(b)(1)(B) of the Energy Emergency Preparedness Act Amendments of 1984"; and proposed section 273(b) would be revised by inserting the same phrase at its beginning. In addition, the phrase, "Except when there is in effect a Presidential declaration that there exists an energy emergency of national or international character," would be inserted at the beginning of paragraphs (A) and (B) of proposed EPCA section 273(a)(2).

We have revised section 2(b)(2) of the bill to make clear that the bill does not itself mandate administrative actions, but rather calls for keeping the Congress informed of administrative actions taken by the Executive Branch. Section 2(b)(2)(B)(ii), which we consider unnecessary, has been deleted. In light of current plans to fill the SPR at a rate of 186,000 barrels per day in fiscal year 1984, section 2(b)(3)(B) has been altered to refer to a mandatory SPR fill rate of 145,000 barrels per day commencing in fiscal year 1985. Finally, the term "petroleum product," which EPCA section 3(3) defines to include crude oil, has been used in this section as well as in certain other places in the bill, in lieu of other terms such as "petroleum" or references to residual fuel oil or other refined products.

As noted below, the Administration opposes certain of the reporting requirements contained in section 7 of the bill. Our proposed amendment to section 2(b)(2) is consistent with the changes we favor in section 7.

Section 3, Energy Emergency Preparedness Organizations: Executive Reserves, and Voluntary Agreements and Plans of Action

The Administration is strongly committed to utilizing the assistance of the private sector, including the energy emergency executive reserves and as necessary, voluntary agreements, in domestic and international energy emergencies to meet both defense-related and non-defense-related needs. The Federal Government cannot maintain, on a continuing basis, sufficient personnel with adequate expertise to be able to respond as needed to a wide range of potential energy emergency situations. Even if such persons were hired initially, very quickly they would lose their level of expertise by virtue of being out of the actual energy business.

There is extensive expertise in the private sector in a wide range of energy operational matters. The Administration wants to be sure that existing conflict of interest and antitrust laws do not serve as a substantial deterrent to private sector involvement in the Government's efforts to deal with energy emergencies, with the result that the Federal Government would be unable to avail itself fully of this pool of talent through effective use of the executive reserve organizations, voluntary agreements, and advisory committees. Industry, whether correctly or not, has a strong apprehension that good faith actions taken by participants in an effort to assist the Federal Government in dealing with actual or prospective energy emergencies may result in civil or criminal litigation, or even in liability. Whether this apprehension is justified or not, these laws should not preclude the United States from having the capability to respond as well as it might to future energy supply disruptions that may occur. Section 3(a) of S. 1678 is an important step in providing this relief by adding to EPCA, new sections 273 and 274, which would provide broader and more flexible authority for the use of DOE's executive reserve organizations and of voluntary agreements and plans of action than is contained in existing law. Accordingly, the Administration supports the need for legislative action on these subjects.

At the same time, the Administration believes it is important to assure that legislation intended to ameliorate this problem does not create a situation which lends itself to abuse. Consequently, we believe that revision of the proposed sections 273 and 274 is necessary to narrow their scope, particularly with respect to the proposed new authority to waive the conflict of interest and antitrust laws.

First, we would revise proposed section 273, concerning executive reserve organizations, in subsections (a)(4), (b) and (c)(1), so that the waiver authority would be used only in connection with "specified activities."

The waiver authority in proposed section 273 with respect to the Federal conflict of interest laws would be limited to waiver of the conflict of interest provisions of the Department of Energy Organization Act. We believe it would be preferable to consider revisions to the criminal code conflict of interest provisions on an across-the-board basis, rather than as special purpose exemptions that would result in the type of "numerous nonuniform ad hoc exemptions" that Congress intentionally eliminated when it recodified the conflict of interest laws in 1962. See H.R. Rep. No. 748, 87th Cong., 1st Sess. 14 (1961). We also believe that authority to waive the criminal code conflict of interest provisions at 18 U.S.C. sections 202-209 should be limited to a potential waiver of the section 208 prohibition on acts affecting a personal financial interest. We therefore have inserted, as subsection (b) to section 3 of the bill, a proposed across-the-board amendment to section 208, which would permit a waiver only if:

> "...the Government official responsible for appointment of the officer or employee, with the concurrence of the Director of Government Ethics, makes a certification, published in the Federal Register, that the national interest would be served by the participation of the officer or employee because the officer or employee has outstanding qualifications not otherwise available and is acting with respect to a particular matter that requires such qualifications, and that--
>
> > (A) the financial interest is not likely to affect the integrity of the services which the Government might expect from such officer or employee; or
> >
> > (B) the participation by such officer or employee in the particular matter will be limited to the rendering of advice and all persons receiving such advice will be notified of the nature and extent of the officer's or employee's financial interest in the matter."

We believe that public disclosure of financial interests will play an important role in fostering public confidence in the integrity of executive reserve organizations. Consequently, we have deleted the proposed authority to waive the financial reporting requirements contained in sections 201-211 of title 5, U.S. Code, and we have revised proposed section 273(a)(6) so that, like the comparable provision at section 710(a)(6) of the Defense Production Act (50 U.S.C. App. section 2160(a)(6)), it calls for publication of financial interest statements of "without compensation" employees.

We further propose to amend section 273 to limit the antitrust law exemption permitted under subsections (a)(4)(B),(b)(2) and (c)(1)(B), by restricting such exemptions to "activities undertaken in good faith within the scope of the employee's official governmental duties."

In addition, we favor amending subsection (f)(2) of the proposed section 274, concerning voluntary agreements and plans of action, to make available the antitrust defense which that section provides only "if and to the extent that" the person asserting the defense can show that his actions were "specified in, or within the reasonable contemplation of" a voluntary agreement or plan of action, "the making of which was initiated by the President." The same condition has been attached, in our revision, to availability of the breach of contract defense contained in section 274(h).

Our amendments also would make a number of other changes in proposed sections 273 and 274:

Authority to utilize the three energy-related executive reserve organizations would be placed directly in the Secretary of Energy rather than in the President.

Section 273(a)(1) would be revised to make clear that "without compensation" employees may participate in training programs.

Sections 273(a)(6) and (c)(2) would be revised to require that an appointee to the executive reserves identify, in his financial interest statement, corporations of which he is or was an "employee."

Sections 273(a)(4)(B), (b)(2), and (c)(1)(B), and section 274(f)(1), would be revised to permit the waiver of State antitrust laws; the referenced subsections of section 273 also would be amended to make the antitrust exemption applicable not only to the person employed in an executive reserve, but also to that person's current or former employer.

Section 273(b) would be revised to limit the authority provided therein to an authority to utilize the "voluntary" services of State and local agencies.

Section 273(c)(1) would clarify that activated executive reservists must be "full-time salaried" employees.

Section 273(d) would be revised to ensure that no Federal official could be considered to be in violation of the advisory committee laws by meeting or consulting with executive reservists.

A new subsection (e) would be added to section 273, providing for the adoption of implementing regulations.

A "national interest" test and a requirement to consider the effect on competition would be added to section 274(a), authorizing the initiation of voluntary agreements and plans of action.

Section 274(c) would be revised to eliminate the redundant requirement in section 274(c)(1)(C) that a full-time Department of Energy employee be present at all meetings; and use of a tape recording to keep the full and complete meeting record would be authorized.

Section 274(d)(1) would be revised to provide that the approval of a voluntary agreement or plan of action by the Secretary of Energy and the Attorney General would not be subject to judicial review, and to stipulate that participation of the Attorney General and the Federal Trade Commission in the carrying out of voluntary agreements and plans of action shall be "as they deem appropriate"; a similar change is made in section 274(e)(1).

Section 274(f) would be revised by adding a new paragraph (3), identical to that now contained in EPCA section 252(f)(3), assigning the burden of proof with respect to the antitrust defense.

Section 274(h), requiring annual reports from the Justice Department and Federal Trade Commission, would be deleted.

Section 274(j) (redesignated as (i)) would be revised to ensure that Federal officials could not be charged with violations of the Federal advisory committee laws when they receive advice from participants in voluntary agreements or plans of action.

Section 274(k) (redesignated as (j)) would be revised to make clear that section 274 could be used as the basis for a voluntary agreement or plan of action to implement domestic "fair sharing" of any U.S. allocation obligation under the Agreement on an International Energy Program.

Section 4, International Energy Program Amendments

We would amend EPCA section 252(d)(1), in a manner identical with our revision of proposed section 274(d)(1), to exclude judicial review of the Government's approval of a voluntary agreement or plan of action.

Section 5, Strategic Petroleum Reserve (SPR)

The amendments which section 5(a) of the bill would make to EPCA section 160(c)(1) to establish a minimum required fill rate of 145,000 barrels per day should apply commencing with fiscal year

1985, in light of existing plans to fill the SPR at a rate of 186,000 barrels per day in 1984. As written, however, these amendments would not eliminate or alter existing section 160(c)(1)(D)(i), which was added to section 160 by EEPA:

> "If funds are available in any given fiscal year after fiscal year 1982 to achieve an average annual fill rate higher than the minimum required fill rate in effect under subparagraph (c), the minimum required fill rate shall be the highest practicable fill rate achievable, subject to the availability of appropriated funds."

So long as this provision remains unchanged, it is questionable whether the other amendments contained in section 5(a) of the bill would have the effect of limiting the requisite SPR fill rate to 145,000 barrels per day after fiscal year 1984. We therefore propose to revise section 5(a) to provide that section 160(c)(1)(D)(i) would be struck from the EPCA.

We would amend the proposed section 160(g) by adding at the end, a sentence calling for the deposit of any proceeds from an SPR test sale in the SPR's off-budget account created pursuant to EPCA section 167(b)(3); otherwise, it would appear that such receipts would have to be paid over to the Treasury's miscellaneous receipts account.

We favor the deletion of proposed section 161(h), concerning priority performance or acceptance of contracts or orders in connection with SPR drawdown. We believe this extraordinary power, under which any person would have to accept a contract or order if he "could be made capable" of performing it without an "unreasonable change" in his normal business practices, is broader than can be justified.

In addition, we have inserted language in proposed section 160(i) (redesignated as (h)) to clarify that the export authority would apply only to oil sold from the SPR during a drawdown.

Section 6, Effect on State Laws

As indicated in Assistant Secretary Vaughan's October 19 letter, the Administration is concerned about the approach which S. 1678 takes to the subject of preemption of state and local laws dealing with the pricing and allocation of petroleum products. Proposed new EPCA section 275 would preempt all such laws in advance of any emergency, irrespective of their purposes or effects, while leaving it to the President to carve out limited exceptions to the general prohibition. We think this reverses the presumption that ought to apply to State and local laws, and represents an unwarranted departure from principles of Federalism. We are cognizant, however, of the concerns that have been voiced that State and local laws could, at some point, aggravate an oil supply disruption before steps were taken to confine them to their proper constitutional scope. In light of these competing considerations, we believe a balanced approach would be to empower the President to preempt only those laws and regulations which require preemption, if during a declared energy emergency of national or international character he concludes that State or local laws are interfering in the domestic marketplace in such a manner as to worsen the emergency and that they unduly burden interstate commerce. We therefore recommend that the following be substituted for subsection (a) of the proposed section 275:

> "(a) PREEMPTION.--(1) When a declaration by the President is in effect that there exists an energy emergency of national or international character, he periodically shall assess whether the adoption of petroleum product pricing or allocation laws by States or political subdivisions thereof interferes or is likely to interfere in the domestic marketplace in such a manner as to worsen the energy emergency nationally and unduly burden interstate commerce. If the President concludes that such interference is occurring or is likely to occur, he may specify, individually or by classes or categories, any or all laws or regulations adopted by States or political subdivisions thereof (except for set-aside programs approved pursuant to subsection (b)) which in his judgment require preemption, and those laws and regulations shall be preempted from the time he so specifies, to the extent that they provide for the pricing or allocation of petroleum products. The President from time to time, in his discretion, may revise the list, classes or categories of preempted laws or regulations, and shall terminate in whole or in part the preemption of such laws or regulations when he finds that they no longer would worsen the energy emergency nationally and unduly burden interstate commerce.
>
> "(2) No action of the President under paragraph (1) shall be subject to judicial review."

Here, and in the following subsections dealing with State set-aside programs and the protection of consumer inventories, we consistently have used the term "petroleum products," which EPCA section 3(3) defines as including crude oil and residual fuel oil as well as any other refined petroleum product.

With respect to the State set-aside programs authorized by proposed section 275(b), we would add to subsection (b)(2) the limitation that this authority does not permit a Governor to fix or limit the price of any petroleum product which is set aside.

We have revised proposed section 275(c) to make applicable on a permanent basis the protection of consumer inventories from State action, regardless of whether a State set-aside program is in effect or State laws are being preempted by the President.

Section 7, Report to the Congress

Finally, in accordance with our opposition to the new reporting requirements contained in section 7 of the bill, we have revised section 7 to provide for the reporting of SPR-related matters in the context of the annual and quarterly SPR reports already called for by existing EPCA section 165, and have eliminated the other reporting provisions of section 7.

S. 1678 provides, in section 4, for extension until June 30, 1985, of the antitrust defense contained in EPCA section 252, pursuant to which U.S. oil companies participate in implementing the Agreement on an International Energy Program. We have made clear our strong support for such an extension. However, a separate bill extending the section 252 antitrust defense, H.R. 4194, is now pending before the Senate, and we urge that consideration of S. 1678 not be allowed to interfere with prompt, favorable Congressional action on H.R. 4194.

The Office of Management and Budget advises that from the standpoint of the President's program, there is no objection to the submission of this report for the consideration of the Committee.

Sincerely,

H. A. Merklein

Helmut A. Merklein
Assistant Secretary for
International Affairs
and Energy Emergencies

Enclosure

98TH CONGRESS
1ST SESSION

S. 1678

To amend the Energy Policy and Conservation Act to strengthen our Nation's energy emergency preparedness consistent with the policy set forth in section 271 of said Act, and for other purposes.

IN THE SENATE OF THE UNITED STATES

July 25, 1983

Mr. McCLURE introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To amend the Energy Policy and Conservation Act to strengthen our Nation's energy emergency preparedness consistent with the policy set forth in section 271 of said Act, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE. - This Act may be cited as the "Energy Emergency Preparedness Act Amendments of ~~1983~~ 1984".

(b) TABLE OF CONTENTS. -

Sec. 1. Short title; table of contents.
Sec. 2. Congressional findings and purposes.
Sec. 3. Energy emergency preparedness organizations: executive reserves, and voluntary agreements and plans of action.

Sec. 4. International energy program amendments.
Sec. 5. Strategic Petroleum Reserve amendments.
Sec. 6. Effect on State laws.
Sec. 7. Report to the Congress.

SEC. 2. FINDINGS AND PURPOSES.

(a) FINDINGS. - The Congress finds that-

(1) legislative and administrative actions are needed to ~~strengthen-and-improve~~ continue the strengthening and improvement of our Nation's energy emergency preparedness in order to implement fully section 271 of the Energy Policy and Conservation Act (42 U.S.C. 6281), which established the policy that the Federal Government shall be prepared prior to any shortage of petroleum products to respond to energy emergencies, as a supplement to reliance on the free market to mitigate the adverse impacts of a shortage of petroleum products on public health, safety, and welfare; and

(2) individual State and local, as well as Federal, pricing and allocation of petroleum products could frustrate free market ~~price~~ pricing and allocation of available petroleum product supplies~~,-and-the-response-of-the-Federal Government-to-energy-emergencies~~.

(b) PURPOSE. - The purpose of this Act is to ~~further~~ carry out further the policy set forth in section 271(b) of the Energy Policy and Conservation Act (42 U.S.C. 6281(b)) by-

(1) amending existing energy emergency authorities to-

(A) assure that such authorities are adequate for, and remove any inconsistencies which may impede, proper implementation of the energy emergency preparedness policy established by section 271(b) of the Energy Policy and Conservation Act (42 U.S.C. 6281(b));

(B) assure the availability and effectiveness of organizations for utilizing the assistance of the private sector, including the energy emergency executive reserves, and voluntary agreements and plans of action, in ~~domestic-and-international energy-emergencies~~ energy emergencies of national or international character in order to meet ~~both~~ defense-related and non-defense-related needs;

(C) extend the expiration date of section 252(j) of the Energy Policy and Conservation Act (42 U.S.C. 6272(j)) to June 30, 1985; and

(D) preserve the ability of the domestic marketplace to work effectively in the event of a severe petroleum supply disruption by protecting against the possibility that ~~States-or-local~~ governments ~~may~~, by the adoption of ~~price~~ pricing and allocation laws, may interfere in the domestic marketplace and thereby worsen energy emergencies;

(2) ~~undertaking~~ keeping the Congress informed of appropriate administrative actions taken ~~to-~~

~~(A)-improve-and-upgrade,-on-a-timely-basis, the-comprehensive-energy-emergency-response procedures-provided-for-the-Energy-Emergency Preparedness-Act-of-1982,-by-incorporating-improvements-that-are-needed-in-light-of-the-results of-ongoing-tests-and-exercises-relating-to-the energy-emergency-response-capabilities-of-the United-States,-and~~

~~(B)~~ to assure, commensurate with the Strategic Petroleum Reserve ~~distribution-plan~~ Distribution Plan and with existing legal authorities, that-

~~(i)~~ the Strategic Petroleum Reserve will be applied to meet domestic needs, including regional hardships, and can be applied to meet international obligations of the United States (including those under the International Energy ~~Agency~~ Program and NATO ~~agreements~~ Agreements); and

~~(ii)-petroleum-products-from-the Strategic-Petroleum-Reserve,-including-any such-petroleum-products-distributed-by directed-sales,-enter-the-market-during the-energy-emergency-and-are-protected from-speculation-and-hoarding,-and~~

(3) completing the Strategic Petroleum Reserve by-

(A) developing a seven hundred and fifty million barrel reserve by the end of fiscal year 1991;

(B) maintaining an average annual fill rate over the fiscal years ~~1984~~ 1985 through 1988 of at least one hundred and forty-five thousand barrels per day, with some necessary year-to-year flexibility to accommodate ~~expecially~~ especially favorable purchases that may arise in the future; and

(C) completing the Big Hill facility on a schedule that will allow fill of the facility to begin no later than the third quarter of fiscal year 1987.

SEC. 3. ENERGY EMERGENCY PREPAREDNESS ORGANIZATIONS: EXECUTIVE RESERVES, AND VOLUNTARY AGREEMENTS AND PLANS OF ACTION.

(a) Part C of title II of the Energy Policy and Conservation Act (42 U.S.C. 6281), relating to energy emergency preparedness, is amended by adding at the end thereof the following new subsections:

"ENERGY EMERGENCY EXECUTIVE RESERVES

"SEC. 273. EMPLOYMENT OF PERSONNEL; APPOINTMENT POLICIES; AND EXECUTIVE RESERVES. - (a)(1) The ~~President~~ Secretary of Energy is authorized, to the extent he deems it necessary and appropriate in order to implement the comprehensive energy emergency response procedures provided for in section 272(b), and subject to such regulations as he may issue, to train and employ persons of outstanding experience and ability without compensation in connection with the activities of the Emergency Petroleum and Gas Executive Reserve, the Emergency Solid Fuels Executive Reserve, and the Emergency Electric Power Executive Reserve of the Department of Energy.

"(2) The ~~President~~ Secretary shall be guided in the exercise of the authority provided in this subsection by the following policies:

"(A) ~~So~~ Except when there is in effect a Presidential declaration that there exists an energy emergency of national or international character, so far as possible, operations to carry out the provisions of this part shall be carried on by full-time, salaried employees of the Federal Government, and appointments under this authority shall be to advisory or consultative positions only.

"(B) ~~Appointments~~ Except when there is in effect a Presidential declaration that there exists an energy emergency of national or international character, appointments to positions other than advisory or consultative may be made under this authority only when the requirements of the position are such that the incumbent must personally possess outstanding experience and ability not obtainable on a full-time, salaried basis.

"(C) In the appointment of personnel and in assignment of their duties, the ~~President~~ Secretary shall take steps to avoid, to as great an extent as possible, any conflict between the governmental duties and the private interests of such personnel.

"(3) Appointees under this subsection shall, when policy matters are involved, be limited to advising appropriate full-time salaried Federal Government officials who are responsible for making policy decisions.

"(4) Notwithstanding any other provision of law, the ~~President~~ Secretary, upon finding that the ~~national-interest requires~~ achievement of the purpose described in section 2(b)(1)(B) of the Energy Emergency Preparedness Act Amendments of 1984 requires such action, may exempt with respect to specified activities persons who become employed pursuant to paragraph (1) from the operation of-

"(A) ~~all-Federal-laws-pertaining-to-conflict-of interest-including,-but-not-limited-to-~~

~~"(i)-sections-202-through-209-of-title-18, United-States-Code,~~

~~"(ii)-sections-201-through-211-of-title-5, United-States-Code,-appendix-I,-and~~

~~"(iii)~~ sections 601 through 608 of the Department of Energy Organization Act (42 U.S.C. 7211-7218); and

"(B) the antitrust laws (as defined in section 3(9)) or any similar State law; provided, that the exemption authorized in this subparagraph (B) shall apply only with respect to activities undertaken in good faith within the scope of the employee's official governmental duties and shall extend to the private employers of the persons who become employed pursuant to paragraph (1).

"(5) Appointments under this subsection shall be supported by written certification by the Secretary ~~of Energy~~ that-

"(A) the appointment is necessary and appropriate in order to implement the Comprehensive Energy Emergency Response Procedures;

"(B) the duties of the position to which the appointment is being made require outstanding experience and ability and

"(C) the appointee has the outstanding experience and ability required by the position.

"(6) The Secretary ~~of Energy~~ shall publish in the Federal Register a statement including the name of the appointee, the title of his position, and the name of his private employer. The appointee shall file with the Secretary ~~of Energy~~ for publication in the Federal Register a statement listing the names of any corporations of which he is an officer, ~~or~~ director, or employee or within 60 days preceding his appointment has been an officer, ~~or~~ director, or employee or in which he owns, or within 60 days preceding his appointment has owned, any stocks, bonds, or other financial interests, and the names of any partnerships in which he is, or was within 60 days preceding his appointment, a partner, and the names of any other businesses in which he owns, or within such 60-day period has owned, any similar interest. At the end of each succeeding 6-month period, the appointee shall file with the Secretary for publication in the Federal Register a statement showing any changes in such interests during such period.

"(7) At least once every 3 months the Director of the Office of Personnel Management shall survey appointments made under this subsection and shall report his findings to the President and the Congress and make such recommendations as he may deem proper.

"(8) Persons appointed under the authority of this subsection may be allowed transportation and per diem in lieu of subsistence while away from their homes or regular places of business pursuant to such appointment, in accordance with title 5 of the United States Code.

"(b) ~~The-President~~ To achieve the purpose of section 2(b)(1)(B) of the Energy Emergency Preparedness Act Amendments of 1984, the Secretary may utilize the voluntary services of ~~Federal,~~ State~~,~~ and local agencies; ~~and-may-utilize-and-establish-such regional,-local,-or-other-agencies,-and-utilize-such-voluntary or-uncompensated-services-from-them,-as-may-from-time-to time-be-needed-to-implement-this-section,~~ and he is authorized to provide ~~by-regulation~~ for the exemption with respect to specified activities of persons whose services are utilized under this subsection from the operation of-

"(1) ~~all-Federal-laws-pertaining-to-conflict-of interest-including,-but-not-limited-to-~~

~~"(A)-sections-202-through-209-of-title-18, United-States-Code,~~

~~"(B)-sections-201-through-211-of-title-5, United-States-Code,-appendix-I,-and~~

"~~(C)~~ sections 601 through 608 of the Department of Energy Organization Act (42 U.S.C. 7211-7218); and

"(2) the antitrust laws (as defined in section 3(9)) or any similar State law; provided, that the exemption authorized in this subparagraph (2) shall apply only with respect to activities undertaken in good faith within the scope of the employee's official governmental duties and shall extend to the State and local agency employers of persons whose services are utilized under this subsection.

"(c)(1) The ~~President~~ Secretary is further authorized to provide for the establishment and training of the Emergency Petroleum and Gas Executive Reserve, the Emergency Solid Fuels Executive Reserve, and the Emergency Electric Power Executive Reserve for full-time salaried employment in executive positions in the Federal Government to assist in implementing the Comprehensive Energy Emergency Response Procedures provided for in section 272(b). ~~Members~~ For the purpose of participating in the executive reserve training program, members of these executive reserves who are not at the time full-time Federal Governmen employees may be allowed transportation and per diem in lieu of subsistence, in accordance with title 5 of the United States Code (with respect to individuals serving without pay, while away from their homes or regular places of business)~~,-for-the-purpose-of participating-in-the-executive-reserve-training-program~~. Notwithstanding any other provision of law, the ~~President~~ Secretary, upon finding that ~~the-national-interest~~ achievement of the purpose described in section 2(b)(1)(B) of the Energy Emergency

Preparedness Act Amendments of 1984 requires such action, may exempt with respect to specified activities members of these executive reserves who become employed by the Federal Government during or in preparation for periods of ~~domestic~~ national or international energy emergency, or who are engaged in the executive reserve training program, from the operation of-

"(A) ~~all-Federal-laws-pertaining-to-conflict-of interest-including,-but-not-limited-to:~~

~~"(i)-sections-202-through-209-of-title-18, United-States-Code;~~

~~"(ii)-sections-201-through-211-of-title-5, United-States-Code,-appendix-I;-and~~

~~"(iii)~~ sections 601 through 608 of the Department of Energy Organization Act (42 U.S.C. 7211-7218); and

"(B) the antitrust laws (as defined in section 3(9)) or any similar State law, provided, that the exemption authorized in this subparagraph (B) shall apply only with respect to activities undertaken in good faith within the scope of the employee's official governmental duties and shall extend to the private employers of persons who become employed pursuant to paragraph (1).

"(2) The Secretary ~~of-Energy~~ shall publish in the Federal Register a statement including the name of a member of these executive reserves who has become employed by the Federal Government, the title of his position, and the name of his private employer. The employee shall file with the Secretary ~~of-Energy~~ a statement listing the names of any corprations of which he is an officer, ~~or~~ director, or employee or within 60 days preceding his employment has been an officer, ~~or~~ director, or employee or in which he owns, or within 60 days preceding his employment has owned, any stocks, bonds, or other financial interests, and the names of any partnerships in which he is, or was within 60 days preceding his employment, a partner, and the names of any other businesses in which he owns, or within such 60-day period has owned, any similar interest. At the end of each succeeding 6-month period, the employee shall file with the Secretary a statement showing any changes in such interests during such period.

"(d) Notwithstanding any other provision of law, ~~personnel used under this section, including persons employed without compensation, the executive reserves and any members of the executive reserves who become employed by the Federal Government during or in preparation for periods of domestic or international energy emergency, or who are engaged in the executive reserve training programs, are exempt from the operation of all Federal laws, rules, and regulations pertaining to advisory committees~~ any activities conducted under this section are exempt from the operation of all Federal laws, rules and regulations pertaining to advisory committees.

"(e) The Secretary, with the concurrence of the Attorney General, shall promulgate regulations implementing the exemptions contained in subsections (a)(4), (b) and (c)(1) of this section.

"VOLUNTARY AGREEMENTS AND PLANS OF ACTION FOR ENERGY EMERGENCIES

"SEC. 274. (a) The President is authorized to consult with representatives of the energy industry, energy consumers, and other interests, ~~with-a-view-to-encouraging-the-making-by~~ in order to initiate and encourage such persons ~~of~~ to participate in voluntary agreements and plans of action which ~~would-be-in~~ he deems important to the ~~public~~ national interest, and which in his judgment would contribute to the objectives of this part by facilitating preparation for, or a response to, ~~a-domestic-or international-energy-emergency~~ an energy emergency of national or international character in a manner that does not unreasonably or unnecessarily interfere with competition.

"(b) The President shall prescribe standards and procedures by which persons may develop and carry out voluntary agreements and plans of action provided for in subsection (a).

"(c) The standards and procedures prescribed under subsection (b) shall include without limitation the following requirements:

"(1)(A) Except as provided in subparagraph (B), meetings held to develop or carry out a voluntary agreement or plan of action under this section shall-

"(i) permit attendance by representatives of committees of the Congress and interested persons, including all interested segments of the energy industry, energy consumers, and the public;

"(ii) be preceded by timely and adequate notice with identification of the agenda of such meeting to the Attorney General, the Federal Trade Commission, committees of the Congress, and (except during an energy emergency with respect to meetings to carry out a voluntary agreement or to develop or carry out a plan of action) the public; and

"(iii) be initiated and chaired by a regular full-time employee of the Department of Energy.

"(B) The President may determine that a meeting held to carry out a voluntary agreement or to develop or carry out a plan of action shall not be open to interested persons or that attendance by interested persons may be limited, if the President finds that a wider disclosure would be detrimental to ~~the-interests-ofthe-United-States~~ achievement of the purpose described in section 2(b)(1)(B) of the Energy Emergency Preparedness Act Amendments of 1984.

~~"(C)-No-meetings-may-be-held-to-develop-or-carry out-a-voluntary-agreement-or-plan-of-action-under-this section-unless-a-regular-full-time-employee-of-the-Department-of-Energy-is-present.~~

"(2) Interested persons permitted to attend such a meeting shall be afforded an opportunity to present, in writing and orally, data, views, and arguments at such meetings, subject to any reasonable limitations with respect to the manner of presentation of data, views, and arguments as the Secretary of Energy may impose.

"(3) A full and complete record, ~~and~~ including where practicable (in order of preference) a verbatim transcript or tape recording, shall be kept of any meeting held, and a full and complete record shall be kept of any communication (other than in a meeting) made, between or among participants or potential participants, to develop or carry out a voluntary agreement or a plan of action under this section. Such record ~~or~~, transcript or tape recording shall be deposited, together with any agreement resulting therefrom, with the Secretary of Energy and shall be available to the Attorney General and the Federal Trade Commission. Such records, ~~or~~ transcripts or tape recordings shall be available for public inspection and copying in accordance with section 552 of title 5, United States Code; except that (A) matter may not be withheld from disclosure under section 552(b) of such title on grounds other than the grounds specified in section 552(b)(1), (b)(3), or so much of (b)(4) as relates to trade secrets; and (B) in the exercise of authority under section 552(b)(1), the President shall consult with the Secretary of State and the Attorney General with respect to questions relating to the foreign policy interests of the United States.

"(4) No provision of this section may be implemented so as to prevent representatives of committees of Congress from attending meetings to which this section applies, or from having access to any transcripts, records, and agreements kept or made under this section. Such access to any transcript or tape recording that is to be kept for any meeting shall be provided as soon as practicable (but not later than 14 days) after that meeting.

"(d)(1) The Attorney General and the Federal Trade Commission ~~shall~~ may participate as they deem appropriate ~~from the beginning~~ in the development, and when practicable, in the carrying out of voluntary agreements and plans of action authorized under this section. Each may propose any alternative which would avoid or overcome, to the greatest extent practicable, possible anticompetitive effects while achieving substantially the purposes of this part. A voluntary agreement or plan of action under this section may not be carried out unless approved by the Secretary of Energy and by the Attorney General, after consultation with the Federal Trade Commission. Prior to the expiration of the period determined under paragraph (2), the Federal Trade Commission shall transmit to the Attorney General its views as to whether such an agreement or plan of action should be approved, and shall publish such views in the Federal Register. The Attorney General, in consultation with the Federal Trade Commission and the Secretary of Energy, shall have the right to review, amend, modify, disapprove, or revoke, on his own motion or upon the request of the Federal Trade Commission or any interested person, any voluntary agreement or plan of action at any time, and, if revoked, thereby withdraw prospectively any immunity which may be conferred by subsection (f) or ~~(i)~~ (h). No approval of a voluntary agreement or plan of action under this subsection shall be subject to judicial review.

"(2) Any voluntary agreement or plan of action entered into pursuant to this section shall be submitted in writing to the Attorney General and the Federal Trade Commission at least 20 days before being implemented; except that ~~during a domestic or international energy emergency found by the President to exist,~~ when there is in effect a Presidentially-declared energy emergency of national or international character, the Secretary of Energy, subject to approval of the Attorney General, may reduce such 20-day period. Any such agreement or plan of action shall be available for public inspection and copying, except that a plan of action shall be so available only to the extent to which records ~~or transcripts~~ are so available as provided in the last sentence of subsection (c)(3). Any action taken pursuant to such voluntary agreement or plan of action shall be reported to the Attorney General and the Federal Trade Commission pursuant to such regulations as may be prescribed under subsections (e)(3) and (4).

"(3) A voluntary agreement or plan of action may not be approved by the Attorney General under this subsection unless such agreement or plan-

"(A) describes the types of substantive actions which may be taken under the agreement or plan, and

"(B) is as specific in its description of proposed substantive actions as is reasonable in light of circumstances known at the time of approval.

"(e)(1) The Attorney General and the Federal Trade Commission shall monitor as they deem appropriate the development and carrying out of voluntary agreements and plans of action authorized under this section in order to promote competition and to prevent anticompetitive practices and effects, while achieving substantially the purposes of this part.

"(2) In addition to any requirement specified under subsections (b) and (c) of this section and in order to carry out the purposes of this section, the Attorney General, in consultation with the Federal Trade Commission and the Secretary of Energy, may promulgate rules concerning the maintenance of necessary and appropriate records related to the development and carrying out of voluntary agreements and plans of action authorized pursuant to this section.

"(3) Persons developing or carrying out voluntary agreements and plans of action authorized pursuant to this section shall maintain such records as are required by rules promulgated under paragraph (2). The Attorney General and the Federal Trade Commission shall have access to and the right to copy such records at reasonable times and upon reasonable notice.

"(4) The Attorney General and the Federal Trade Commission may each prescribe such rules as may be necessary or appropriate to carry out their respective responsibilities under this section. They may both utilize for such purposes and for purposes of enforcement any powers conferred upon the Federal Trade Commission or the Department of Justice, or both, by the antitrust laws or the Antitrust Civil Process Act; and wherever any such law refers to 'the purposes of this Act' or like terms, the reference shall be understood to include this section.

"(f)(1) There shall be available as a defense to any civil or criminal action brought under the antitrust laws (as defined in section 3(9)) or any similar State law in respect to actions taken to develop or carry out a voluntary agreement or plan of action (provided that such actions were not taken for the purpose of injuring competition) that-

"(A) such actions were taken-

"(i) in the course of developing a voluntary agreement or plan of action pursuant to this section, the making of which was initiated by the President, or

"(ii) to carry out a voluntary agreement or plan of action authorized and approved in accordance with this section, the making of which was initiated by the President, and

"(B) the persons taking such actions complied with the requirements of this section and the rules promulgated hereunder.

"(2) Except in the case of actions taken to develop a voluntary agreement or plan of action, the defense provided in this subsection shall be available only if and to the extent that the person asserting the defense demonstrates that the actions were ~~described~~ specified in, or within the reasonable contemplation of an approved voluntary agreement or plan of action the making of which was initiated by the President.

"(3) Persons interposing the defense provided by this subsection shall have the burden of proof upon the elements of the defense, except that the burden shall be on the person against whom the defense is asserted with respect to whether the actions were taken for the purpose of injuring competition.

"(g) No provision of this section shall be construed as granting immunity for, or as limiting or in any way affecting any remedy or penalty which may result from any legal action or proceeding arising from, any act or practice which occurred prior to the date of enactment of this section or subsequent to its expiration or repeal.

~~"(h) The Attorney General and the Federal Trade Commission shall each submit to the Congress and to the President, at least once annually, a report on the impact on competition and on small business of actions authorized by this section.~~

"~~(i)~~ (h) In any action in any Federal or State court for breach of contract, there shall be available as a defense that the alleged breach of contract was caused predominantly by action taken during ~~a-domestic-or-international-energy-emergency found-by-the-President-to-exist~~ a Presidentially-declared energy emergency of national or international character, to carry out a plan of action authorized and approved in accordance with this section, the making of which was initiated by the President.

"~~(j)~~ (i) Notwithstanding any other provision of law, ~~participants-in-voluntary-agreements-or-plans-of-action,-when acting~~ any activities conducted under this section, when conducted in compliance with the requirements of this section, the rules promulgated hereunder, and the provisions of the voluntary agreement or plan of action, are exempt from the operation of all Federal laws, rules, and regulations pertaining to advisory committees.

"~~(k)~~ (j) The authority provided by this section shall not apply to the development or carrying out of voluntary agreements or plans of action to implement the allocation and information provisions of the international energy program; provided, that this shall not preclude or limit the applicability of the authority to voluntary agreements or plans of action for domestic fair sharing in connection with such implementation.

(b) Section 208(b) of title 18, United States Code, relating to acts affecting a personal financial interest, is amended by striking "." in clause (2), after the word "services", and inserting in lieu thereof --

> "; or (3) if the Government official responsible for appointment of the officer or employee, with the concurrence of the Director of the Office of Government Ethics, makes a certification, published in the Federal Register, that the national interest would be served by the participation of the officer or employee because the officer or employee has outstanding qualifications not otherwise available and is acting with respect to a particular matter that requires such qualifications, and that --
>
> > "(A) the financial interest is not likely to affect the integrity of the services which the Government might expect from such officer or employee; or
> >
> > "(B) the participation by such officer or employee in the particular matter will be limited to the rendering of advice and all persons receiving such advice will be notified of the nature and extent of the officer's or employee's financial interest in the matter."

~~(b)~~ (c) CONFORMING AMENDMENTS. - Section 271 of the Energy Policy and Conservation Act (42 U.S.C. 6281) is amended-

(1) in subsection (b), by deleting "other than this part" and inserting in lieu thereof, "other than section 272".

(2) in subsection (c), by deleting "other than this part" and inserting in lieu thereof, "other than section 272, and by making available to the President authorities for utilizing the private sector in implementing this policy".

~~(c)~~ (d) The table of contents of the Energy Policy and Conservation Act is amended further by inserting after the item relating to section 272 the following:

"Sec. 273. Energy emergency executive reserves.
"Sec. 274. Voluntary agreements and plans of actions
for energy emergencies.".

SEC. 4. INTERNATIONAL ENERGY PROGRAM AMENDMENTS.

(a) EXTENSION - Subsection (j) of section 252 of the Energy Policy and Conservation Act (42 U.S.C. 6272(j)) is amended by striking out "December 31, 1983" and inserting in lieu thereof "June 30, 1985".

(b) OTHER AMENDMENTS. - Section 252 of the Energy Policy and Conservation Act (42 U.S.C. 6272) is amended-

(1) in subsection (d)(1), by adding at the end thereof, "No approval of a voluntary agreement or plan of action under this subsection shall be subject to judicial review."

~~(1)~~ (2) in subsection (d)(3), by deleting "known circumstances" and inserting in lieu thereof, "circumstances known at the time of approval";

~~(2)~~ (3) in subsection (e)(2), by deleting "shall" and inserting in lieu thereof, "may";

~~(3)~~ (4) in subsection (f)(2), by inserting after "approved", the phrase "voluntary agreement or"; and

~~(4)~~ (5) in subsection (i), by deleting "once every 6 months" and inserting in lieu thereof "annually".

SEC. 5 STRATEGIC PETROLEUM RESERVES AMENDMENTS.

(a) CONFORMING AMENDMENTS. - Section 160 of the Energy Policy and Conservation Act (42 U.S.C. 6240) is amended-

(1) in subsection (c)(1)(A), by striking "500,000,000" and inserting in lieu thereof "750,000,000";

(2) by striking subsections (c)(1)(B) and (C), and inserting in lieu thereof the following:

"(B) The minimum required fill rate in any given fiscal year after fiscal year 1984 shall be 145,000 barrels per day for the purposes of subparagraph (A).";

(3) by redesignating subsection (c)(1)(D) as subsection (c)(1)(C);

(4) in redesignated subsection (c)(1)(C), striking paragraph (i), deleting "(ii)", and deleting "(C)" and inserting in lieu thereof "(B)"; and

(5) in subsection (c)(2), by striking "300,000" and inserting in lieu "145,000".

(b) CLARIFYING AMENDMENTS. - Section 161 of the Energy Policy and Conservation Act (42 U.S.C. 6241) is amended by adding the following new subsections:

"(g) Nothing in this part shall be construed to limit the authority of the Secretary of Energy to conduct sales of petroleum products stored in the Strategic Petroleum Reserve for the purposes of testing drawdown and distribution of the Reserve; such sales shall not be considered to be drawdown and distribution under this section. The receipts from such sales shall be deposited in the "SPR Petroleum Account" under section 167 and shall be subject to section 167(d).

~~"(h) The President is hereby authorized to require that performance under any contracts or orders (other than contracts of employment) which he deems necessary or appropriate to implement drawdown and distribution of the Strategic Petroleum Reserve, including service contracts, shall take priority over performance under any other contract or order, except a conflicting contract or order issued pursuant to section 101(a) of the Defense Production Act (50 U.S.C. App. 2071(a)), and for the purpose of assuring the priority transportation of Reserve petroleum products during drawdown and distribution, to require acceptance and performance of such contracts or orders in preference to other contracts or~~

~~orders-by-any-person-he-finds-is-capable-of-their-performance or-could-be-made-capable-without-an-unreasonable-change-in that-person's-normal-business-practices,~~

"~~(i)~~ (h) Notwithstanding any other provision of law, the President may permit any crude oil withdrawn and sold from the Strategic Petroleum Reserve in accordance with the provisions of this section to be exported to any country pursuant to an arrangement for the delivery of refined petroleum products to the United States.".

SEC. 6. EFFECT ON STATE LAWS.

(a) Part C of title II of the Energy Policy and Conservation Act, relating to energy emergency preparedness, is further amended by adding at the end thereof the following new section:

"EFFECT ON STATE LAWS

"SEC. 275. ~~(a)-PREEMPTION.---(1)-Except-as-provided in-paragraph-(2)-and-subsection-(b),-any-law-or-regulation adopted-or-promulgated-by-a-State-or-any-political-subdivision-thereof,-to-the-extent-that-such-law-or-regulation-provides-for-the-pricing-or-allocation-of-residual-fuel-oil-or-any other-petroleum-product,-is-hereby-preempted.~~

~~"(2)-The-President-may,-by-rule-or-order,-exempt-from the-operation-of-paragraph-(1)-classes-or-categories-of-laws-or regulations,-or-specific-laws-or-regulations,-which-would-otherwise-be-preempted-under-paragraph-(1),-to-the-extent-that the-President-determines-that-such-laws-or-regulations-would-~~

"~~(A)-preserve-a-significant-State-or-local-interest;~~

"~~(B)-not-unduly-burden-interstate-commerce;-and~~

"~~(C)-not-interfere-with-the-policy-established-by section-271.~~ When a declaration by the President is in effect that there exists an energy emergency of national or international character, he periodically shall assess whether the adoption of petroleum product pricing or allocation laws by States or political subdivisions thereof interferes or is likely to interfere in the domestic marketplace in such a manner as to worsen the energy emergency nationally and unduly burden interstate commerce. If the President concludes that such interference is occurring or is likely to occur, he may specify, individually or by classes or categories, any or all laws or regulations adopted by States or political subdivisions thereof (except for set-aside programs approved pursuant to subsection (b)) which in his judgment require preemption, and those laws and regulations shall be preempted from the time he so specifies, to the extent that they provide for the pricing or allocation of petroleum products. The President from time to time, in his discretion, may revise the list, classes or categories of preempted laws or regulations, and shall terminate in whole or in part the preemption of such laws or regulations when he finds that they no longer would worsen the energy emergency nationally and unduly burden interstate commerce.

"(2) No action of the President under paragraph (1) shall be subject to judicial review.

"(b) STATE SET-ASIDE. - The Governor of any State may notify the President of the Governor's intent to implement, under State law and in accordance with the requirements of this subsection, a State set-aside program for ~~residual-fuel-oil-or~~ any ~~other-refined~~ petroleum product.

"(2) For purposes of this subsection, the term 'State set-aside program' means with respect to ~~residual-fuel-oil-or~~ any ~~other-refined~~ petroleum product, a program administered by the State under State law and which-

"(A) is implemented only upon a determination by the Governor that the program is required to meet a petroleum product supply shortage within the State which will significantly impair essential public services or essential economic activity;

"(B) continues in effect for no more than 90 days;

"(C) authorizes the Governor to require a prime supplier of ~~residual-fuel-oil-or~~ any ~~other-refined~~ petroleum product subject to the program to set aside in any month a volume of such ~~residual-fuel-oil-or-other-refined~~ petroleum product for distribution under the program which volume does not exceed 5 percent of the total supply, as estimated by such supplier, of such ~~residual-fuel-oil-or-other-refined~~ petroleum product which will be sold by the supplier in the State for consumption within the State in that month;

"(D) defines a prime supplier as a supplier which makes the first sale of that ~~residual-fuel-oil-or-other refined~~ petroleum product subject to the State set-aside into the State distribution system for consumption within the State;

"(E) does not authorize the Governor to fix or limit the price of any petroleum product which is set aside; and

"~~(E)~~ (F) does not unduly burden interstate commerce.

"(3)(A) The Governor shall provide the President with notice under paragraph (1), accompanied by a request for approval of the State set-aside program the Governor intends to implement, at least 10 days prior to the date on which the Governor intends to implement the program.

"(B) Within 10 days after receipt of such notice and request transmitted by the Governor, the President ~~shall~~, in his discretion, shall either approve or disapprove such request and notify the Governor of the President's action.

"(C) To the extent that the President approves the request within such 10-day period, the program shall then be exempt from the operation of subsection (a).

"(D) If the President does not approve such request within such 10-day period, the request shall be considered disapproved and the program shall not be exempt under this subsection from the operation of subsection (a).

"(E) The President's approval of any program under this subsection may be in whole or in part, but only so much of any State set-aside program as the President approves under this paragraph may be implemented.

"(4) Notwithstanding the 90-day limitation in paragraph (2)(B), an exemption under this subsection allowing implementation of any State set-aside program may be extended by the President for successive 90-day periods if the Governor transmits a notice and request therefor to the President and the President approves such request prior to the expiration of the applicable 90-day period. For such purposes, the preceding provisions of this subsection shall apply with respect to any notice and request for such an extension as if it were for exemption for initial implementation.

"(5) Any approval or disapproval by the President of a request under paragraph (3) or (4) shall not be subject to judicial review.

"(c) PROTECTION OF CERTAIN INVENTORIES. - (1) ~~Notwithstanding subsection (b), no~~ No State shall have authority to-

"(A) provide for the allocation of consumer petroleum product inventories,

"(B) impose restrictions on the consumption of such inventories, or

"(C) consider or take into account the existence or size of such inventories in determining the amount of petroleum products to be allocated to any such consumer.

"(2) For purposes of paragraph (1)-

"(A) The term 'consumer petroleum product inventory' means an inventory of ~~residual-fuel-oil-or-other-refined~~ petroleum products which ~~is~~-

~~"(i)-held-by-and-in-the-custody-of~~ is owned by a consumer (other than a refiner, except to the extent provided in subparagraph ~~(C)~~ (B) for such consumer's own end-use consumption~~,~~.

~~"(ii)-held-by-and-in-the-custody-of-such-consumer-on-the-day-before-the-date-on-which-a State-set-aside-program-is-implemented,-and~~

~~"(iii)-not-thereafter-sold-by-such-consumer, but-only-to-the-extent-that-such-inventory-does not-exceed-the-inventory-of-residual-fuel-oil-and refined-petroleum-products-held-by-and-in-the-custody-of-that-consumer-for-its-own-end-use-consumption-on-the-30th-day-prior-to-the-date-of such-implementation.~~

~~"(B)-The-term-'held-by-and-in-the-custody-of', when-used-with-respect-to-an-inventory,-means-any such-inventory-owned-by-the-consumer-and-in-the direct-possession-of-the-consumer,-such-as-on-the-consumer's-site,~~

"~~(C)~~ (B) The term 'end-use consumption', in the case of an inventory of ~~residual-fuel-oil-or-other-refined~~ petroleum products of any consumer which is a refiner, means the use by the refiner of such ~~residual-fuel-oil-or other-refined~~ petroleum products to meet normal fuel requirements necessary for operating refinery equipment and facilities.".

(b) CONFORMING AMENDMENTS. - Section 271 of the Energy Policy and Conservation Act is amended-

(1) in subsection (a)(2), by deleting "and";

(2) in subsection (a)(3), by deleting the period and inserting in lieu thereof a semicolon and the word "and";

(3) in subsection (a), by adding the following new paragraph:

"(4) individual State and local, as well as Federal, pricing ~~or~~ and allocation of petroleum products could frustrate free market pricing and allocation of available petroleum supplies~~,-and the-response-of-the-Federal-Government-to-energy emergencies~~."; and

(4) in subsection (c), by inserting after, "than this part", a semicolon and "further, by preventing individual ~~State-and-local~~ petroleum product pricing or allocation laws or regulations from interfering with the carrying out of this policy.".

(c) The table of contents of the Energy Policy and Conservation Act is amended by inserting after the new item relating to section 274 the following:

"Sec. 275. Effect on State laws.".

(a) The Energy Emergency Preparedness Act of 1982 is amended by adding at the end thereof the following new section:

"SEC. 7. REPORT TO THE CONGRESS.

"(a) The Secretary of Energy ~~shall undertake, pursuant to authorities otherwise available under existing law, additional actions necessary to strengthen and improve our Nation's energy emergency preparedness in order to implement fully the policy established by section 271(b) of the Energy Policy and Conservation Act (42 U.S.C. 6281(b)). The Secretary~~ shall report, as specified in subsection (b), to the Congress on any ~~such~~ actions taken~~, including, but not limited to, measures~~ to-

~~"(1) improve and upgrade on a timely basis, the comprehensive energy emergency response procedures provided for by section 272(b) of the Energy Emergency Preparedness Act of 1982 (42 U.S.C. 6282(b)) by incorporating improvements (including improvements in Department of Energy organization, interagency coordination, decisionmaking procedures, and emergency alert systems and logistics support) that are needed in light of the results of ongoing tests and exercises relating to the energy emergency response capability of the United States,~~

"~~(2) assure the availability and effectiveness of organizations for utilizing the assistance of the private sector, including the energy emergency executive reserves, and voluntary agreements and plans of action, in domestic and international energy emergencies in order to meet both defense-related and non-defense-related needs,~~

"~~(3) preserve the ability of the domestic marketplace to work effectively, in the event of a severe petroleum supply disruption, by protecting against the possibility that States or local governments may, by the adoption of price and allocation laws, interfere in the domestic marketplace and thereby worsen energy emergencies,~~

"~~(4)~~ (1) assure, commensurate with the Strategic Petroleum Reserve Distribution Plan and with existing legal authorities, that—

"(A) the Strategic Petroleum Reserve will be applied to meet domestic needs (including regional hardships) and can be applied to meet international obligations of the United States (including those under the International Energy ~~Agency~~ Program and North Atlantic Treaty Organization ~~agreements~~ Agreements); and

"(B) petroleum products from the Strategic Petroleum Reserve, including any such petroleum products distributed by directed sales, enter the market during the energy emergency and are protected from speculation and hoarding; and

"~~(5)~~ (2) complete the Strategic Petroleum Reserve by-

"(A) developing a 750 million barrel Reserve by the end of fiscal year 1991;

"(B) maintaining an average annual fill rate over the fiscal years ~~1984~~ 1985 through 1988 of at least 145,000 barrels per day, with some necessary year-to-year flexibility to accommodate especially favorable purchases that may arise in the future; and

"(C) completing the Big Hill facility on a schedule that will allow fill of the facility to begin no later than the third quarter of fiscal year 1987.

"(b) ~~Within-3-months~~ In the next quarterly Strategic Petroleum Reserve report required under subsection 165(b) of the Energy Policy and Conservation Act after the date of enactment of this section, and annually thereafter in the annual Strategic Petroleum Reserve report required under subsection 165(a) of that Act, the Secretary of Energy shall ~~submit-a~~ report to the Congress ~~containing-a-description-of~~ on the actions taken pursuant to subsection (a) ~~and-any-other-actions-taken-to-strengthen-and improve-our-Nation's-energy-emergency-preparedness-in-order-to further-carry-out-the-policy-set-forth-in-section-271(b)-of-the Energy-Policy-and-Conservation-Act-(42-U.S.C.-6281(b))~~.".

U.S. Department of Justice
Office of Legislative Affairs

Official Committee File

Office of the Assistant Attorney General

Washington, D.C. 20530

6 FEB 1984

SENATE COMMITTEE ON
ENERGY AND NATURAL RESOURCES
RECEIVED
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Honorable James A. McClure
Chairman, Committee on Energy
and Natural Resources
U.S. Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This letter is in response to your request for the views of the Department of Justice on S. 1678, the "Energy Emergency Preparedness Act Amendments of 1983," and to the questions which you enclosed in your letter of October 24, 1983, to the Attorney General. The Department of Justice supports and encourages legislative efforts to address the energy emergency preparedness issues that are the subject of S. 1678. We will support enactment of the bill if § 3 is amended to eliminate or revise substantially certain provisions that raise serious questions about the proper scope and purpose of the federal conflict-of-interest and antitrust laws.

The questions which you enclosed in your letter of October 24 concerned the role of the Department of Justice in examining S. 1678, our views on the conflict-of-interest and antitrust issues it raises, and the fact that the Department did not testify at the Committee's October 19, 1983, hearing on emergency preparedness. The Department of Justice has for some time been engaged in an examination of S. 1678 and a review of the issues it presents. As explained in this letter, we do have concerns about the conflict-of-interest and antitrust issues it presents and, in collaboration with other parts of the Administration, have sought to arrive at constructive suggestions of amendments to the bill which would make it acceptable. Specifically, this Department has worked with the Department of Energy and the Office of Government Ethics to develop an alternative that we believe will accomplish the purposes of the bill without sacrificing the important protections afforded by the conflict-of-interest and antitrust laws. Attached hereto is a copy of S. 1678 that has been marked to reflect those changes. If the bill is revised to incorporate those changes, the Department of Justice will support enactment of this legislation.

The Department of Justice did not choose to testify at the October 19 hearing because the Administration's position on the provisions of concern to this Department, specifically those sections of S. 1678 relating to the conflict-of-interest and antitrust laws, was still under review during the week prior to the hearing. It did not appear that a position would be developed by the day of the hearing. Until the position was finalized, we did not believe it appropriate to appear at the hearing since all we could have stated was that the issues were under review. While Assistant Secretary of Energy Vaughan did set forth in his prepared statement the Administration's position, the matter was not finalized until just prior to the hearing. The Department's Office of Legislative Affairs notified Richard Grundy of the Committee staff by telephone on October 14, 1983, that a representative would not appear at the hearing.

I. Section 3

The section of S. 1678 that is of greatest concern to the Department of Justice is § 3(a), which would amend the Energy Policy and Conservation Act, 42 U.S.C. §§ 6201 *et seq*. ("EPCA"), by adding two new sections, §§ 273 and 274. We set out below our specific concerns about the authority provided by each of those sections.

A. § 273, Employment of Private Sector Personnel

Proposed § 273 of EPCA, which would be added by § 3(a) of S. 1678, would authorize the use by the federal government of individuals from the private sector or from federal, state, and local agencies to plan for and deal with energy emergencies. 1/ Section 710 of the Defense Production Act, 50 U.S.C. app. § 2160 ("DPA"), authorizes, under certain circumstances, the training and employment of persons from the private sector in order to facilitate such activities. 2/ The DPA does not, however, provide individuals and their private employers serving pursuant to § 710 any statutory immunity from either the federal conflict-of-interest laws or the antitrust laws. Initially, § 710 provided an exemption from the federal conflict-of-interest provisions, but this was made inapplicable when the conflict-of-interest laws were recodified in 1962. See § 2, Pub. L. No. 87-849, 76 Stat. 1126. Proposed § 273 of EPCA, as now written, would allow the President to grant those individuals a broad exemption from the prohibitions of the federal conflict-of-interest laws and immunity from suit under the federal antitrust laws. Specifically, it would authorize the President

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1/ The Administration supports certain revisions to that authority. As shown on the revised version of S. 1678 attached hereto, these include: (1) giving the Secretary of Energy, rather than the President, the authority to employ such individuals (§ 273(a)(1), (b), & (c)); (2) providing consistently that employment of such individuals will be authorized as the Secretary of Energy may find necessary to achieve the purposes of § 2(b)(1)(B) of the bill (§ 273(a)(1), (b), & (c)); (3) restricting the authority provided in § 273(b), with respect to use of federal, state, and local agencies, to acceptance by the Secretary of Energy of voluntary services from state or local agencies; and (4) adding a new subsection (e) that would provide for issuance of procedural regulations to govern employment of individuals under § 273, which regulations would be issued by the Secretary of Energy with the concurrence of the Attorney General.

2/ 50 U.S.C. app. § 2160(b) & (e). Subsection (b) permits the President to employ "persons of outstanding experience and ability" to serve without compensation in advisory positions to assist in carrying out the purposes and provisions of the DPA. 50 U.S.C. app. § 2160(b). Subsection (e) authorizes the establishment and training of an "executive reserve" for employment during "periods of emergency." 50 U.S.C. app. § 2160(e).

to exempt from those laws: (1) special government employees serving without compensation (WOCs) in connection with activities of three executive reserves, 3/ regardless whether the reserves were activated, if he found such exemption to be in the "national interest"; (2) persons from federal, state, and local agencies whose services are used to plan for or deal with energy emergencies; and (3) members of the executive reserves who become employed by the federal government during, or in preparation for, periods of a domestic or international energy emergency, or who are engaged in the executive reserve training program, if he found that such an exemption was in the "national interest."

The Administration is strongly committed to using the assistance of the private sector as an integral part of our domestic and international energy emergency preparedness program. The Department of Justice does not oppose enactment of explicit statutory authority for the employment or use of such individuals to the extent existing statutory authority may be inadequate. The Department does have substantial concerns, however, about the scope of the authority that would be granted to the President by S. 1678 to exempt such individuals from the federal conflict-of-interest and antitrust laws. While we do not want the conflict-of-interest and antitrust laws to preclude necessary and effective use of private sector personnel in future times of crisis or in planning for crises, we are concerned that the breadth of the immunity provisions as now written could create a situation that lends itself to abuse. The attached mark-up of S. 1678 would, we believe, sufficiently narrow the breadth of the immunity provision to eliminate any undue risk.

Our concerns with respect to the conflict-of-interest issues and the antitrust issues are set forth separately below.

3/ These reserves are the Emergency Petroleum and Gas Executive Reserve, the Emergency Solid Fuels Executive Reserve, and the Emergency Electric Power Executive Reserve, all of the Department of Energy. The Administration has announced its intention to consider use of these energy-related executive reserves in order to rely upon private sector personnel in dealing with energy emergencies.

1. Conflict-of-interest

We are concerned about the grant of blanket authority to waive the conflict-of-interest laws provided by proposed § 273 because we believe that, if an overly broad waiver of the conflict-of-interest laws were enacted, the employment of persons from the private sector to assist the Government in all phases of its response to energy emergencies would raise the sort of opportunity for self-dealing and abuse of governmental position that the federal conflict-of-interest laws are intended to prevent. Individuals employed pursuant to the authority in proposed § 273 could be involved in every phase of the Government's response to an energy crisis, from overall policy planning to actual award of contracts and orders to individual companies. For example, an executive of a major utility could be employed as an aide and policy advisor to the Secretary of Energy, or in an executive position within the Department of Energy with responsibility for the industry in which the individual had been employed; an employee of an oil company could also be responsible for reviewing and awarding contracts for the sale of oil. In each case, if that individual were exempted from the federal conflict-of-interest provisions, he or she could receive a salary or other remuneration from his or her employer as compensation for government services (see 18 U.S.C. § 209), give advice, make decisions or award contracts that would favor his or her employer (see 18 U.S.C. § 208), and use his or her position otherwise to assist that employer in dealing with the Government (see 18 U.S.C. § 205). If those employees were routinely granted blanket waivers from all conflict-of-interest laws, we would be concerned that this involvement would create a very serious risk of abuse of government position and of the public trust. We recognize, however, that the impetus for the exemption authority in proposed § 273 is a concern that the conflict-of-interest laws may in some circumstances create problems for recruitment of private sector personnel who have special skills or expertise that does not happen to be maintained within the Government, and may prevent efficient use of those personnel once they are in government service.

Concerns about the deterrent effect of the conflict-of-interest laws on recruitment and use of private sector personnel are not necessarily unique to energy emergency planning. We are therefore concerned that the broad exemption authority in proposed § 273 would set a precedent for other similar exemptions that would result in the type of "numerous nonuniform ad hoc exemptions" that Congress intentionally eliminated when it recodified the federal conflict-of-interest laws in 1962, see H. Rep. No. 748, 87th Cong., 1st Sess. 14 (1961), 4/ and would result in inconsistent, disparate, and overlapping treatment of private sector personnel employed by various agencies and departments of the federal government to meet particular needs. This result would be impossible to administer, would create difficult problems of interpretation and application, and would considerably undermine the purposes served by the conflict-of-interest laws and the public confidence in those laws.

Accordingly, we believe that any revision to the criminal conflict-of-interest laws in title 18 of the U.S. Code should be considered on an across-the-board basis, as an amendment to the conflict-of-interest laws themselves, rather than as special purpose exemptions included in other statutes. In order to give flexibility to implement the private sector program, in accordance with the needs expressed in Assistant Secretary Vaughan's October 19, 1983, letter presenting the Administration's views on S. 1678, and to provide a uniform solution to recurrent problems involving application of the conflict-of-interest laws to private sector personnel whose services and expertise may be invaluable to the federal government in particular situations, we are prepared to support an amendment to 18 U.S.C. § 208, which is the conflicts statute of primary concern to private sector personnel recruited to serve in the Government on a temporary basis, to allow a limited "national interest" waiver of the restrictions imposed by that statute. This amendment, which would become § 3(b)

4/ The legislative solution reached at that time to the recurrent problem of recruiting and using uniquely qualified private sector personnel to assist the Government on a temporary or intermittent basis was to create the category of "special government employees" -- i.e., individuals who are employed for not more than 130 days in any 365-day period -- and to tailor the applicability of the conflict-of-interest laws to reflect the different considerations involved in employment of such individuals. See H. Rep. No. 748, supra at 26; S. Rep. No. 2213, 87th Cong., 2d Sess. 7 (1962).

of the bill (see attachment), would replace subsections (a)(4)(A)(i) & (ii), (b)(1)(A) & (B), and (c)(1)(A)(i) & (ii) of proposed § 273. 5/

Section 208 imposes criminal penalties on any government employee, including a special government employee, who participates personally and substantially for the Government in a particular matter in which he, his spouse or minor child, or a partner or an organization by which he is employed, has an arrangement for future employment, or is negotiating concerning employment, has a financial interest. The section now permits waivers of the prohibition in two situations: (1) on a case-by-case basis, if the government official responsible for appointment of the individual makes a written determination that the financial interest is not so substantial as to be deemed likely to affect the integrity of the services which the Government may expect from the individual; or (2) by general rule or regulation, if the financial interest has been exempted as being too remote or too inconsequential to affect the integrity of the individual's services to the Government. 18 U.S.C. § 208(b).

The amendment we propose would authorize a third category of waiver, contingent on a certification by the government official responsible for appointment of the individual that the national interest would be served by the individual's participation because he or she has outstanding qualifications not otherwise available and is acting with respect to a particular matter that requires such qualifications. The

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5/ As now written, § 273 would authorize waivers, *inter alia*, of the conflict-of-interest restrictions contained in the Department of Energy Organization Act, 42 U.S.C. §§ 7211-18, which are in addition to, and in some respects more stringent than, the restrictions imposed by Title 18 and the financial disclosure requirements in Title 5. Because those restrictions are unique to the Department of Energy, the Department of Justice does not object to inclusion of waiver authority in proposed § 273 for those particular statutory provisions. We cannot support, however, waiver of the financial disclosure requirements of 5 U.S.C. §§ 201-11, or amendment of conflict-of-interest provisions in Title 18 other than § 208. For the most part, however, those provisions in Title 18 either would not be applicable to individuals employed under § 273 or already contain waiver provisions that could be used, if necessary and appropriate, to exempt particular individuals from those restrictions.

official would also have to certify either that the financial interest would not be likely to affect the integrity of the services which the Government might expect from the individual, or that the individual's participation in the particular matter will be limited to the rendering of advice and all persons receiving such advice will be notified of the nature and extent of the financial interest involved. Because we believe that the prohibitions of § 208 should not be waived lightly, this waiver authority would be subject to several procedural limitations. The waiver could be granted only on a case-by-case basis. It would require the concurrence of the Office of Government Ethics, which is the Executive Branch office specifically charged with oversight of the federal conflict-of-interest statutes, and the certification would have to be published in the Federal Register prior to grant of any such waiver.

We believe that this proposed amendment to § 208 will address the concerns reflected in Assistant Secretary Vaughan's October 19 letter about the effect of the conflict-of-interest laws on the Government's ability to recruit and use private sector personnel who have expertise not available within the federal government to meet critically important national needs, and will do so in a comprehensive and uniform fashion.

2. Antitrust

The antitrust immunity that would be provided by proposed § 273 is very broadly worded. At least by its own terms, it is not limited to the official duties of the private sector individuals, many of whom would retain positions in private industry. The Department of Justice has previously stated that actions taken by such officials within the scope of their governmental authority do not ordinarily give rise to antitrust concerns. 6/ Thus, because participation of executive reservists in the Government's planning for, and responding to, energy emergencies is not inherently inconsistent with the antitrust laws, there is no need for the broadly worded immunity in proposed § 273.

6/ Memorandum of Law, "Legal Authorities Available to the President to Respond to a Severe Energy Supply Interruption or Other Substantial Reduction in Available Petroleum Products," at 40-41 (Office of Legal Counsel, Department of Justice, November 15, 1982). In general, antitrust liability attaches only to private conduct that has anticompetitive consequences. See *Parker* v. *Brown*, 317 U.S. 341 (1943); *Sea-Land Service, Inc.* v. *The Alaska Railroad*, 659 F.2d 243 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 919 (1982).

As indicated in Assistant Secretary Vaughan's October 19 letter, however, there is a reluctance on the part of industry personnel to participate in reservist-type activities because of an apprehension that good faith actions might result in civil or criminal litigation or even in antitrust liability. As noted above, this Department does not object to the use of private sector personnel, including executive reservists, in planning for and responding to national or international energy emergencies. We recognize that uncertainty as to the applicability of antitrust laws to reservists and their activities could deter some industry representatives from participating in reserve programs.

To accomodate these concerns, the Department of Justice would not object to a limited statutory immunity tailored to specifically identified needs. However, any immunity afforded by legislation along the lines of § 273 should be explicitly limited to activities undertaken in good faith within the scope of the employee's official governmental duties. The mark-up of S. 1678 accompanying this letter therefore seeks to tailor the immunity to fit the perceived needs.

B. § 274, Voluntary Agreements

S. 1678 would also amend EPCA by adding a new § 274, which would authorize the President to consult with the energy industry and others to encourage the making of voluntary agreements and plans of action to facilitate energy emergency planning and response. The provisions of § 274 can be compared with two other laws which provide for the formation of voluntary agreements. Section 252 of EPCA, 42 U.S.C. § 6272, which lapsed on December 31, 1983, when Congress failed to act on its extension, provides for voluntary agreements and plans of action to implement the allocation and information provisions of the Agreement on the International Energy Program (IEP). 7/ Section 252(f) of EPCA, 42 U.S.C. § 6272(f), provides a limited antitrust defense for activities of U.S. oil companies to develop or carry out voluntary agreements under the IEP. The authorities in § 252, however, are limited to industry participation in support of certain

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7/ The text of the current agreement, as amended, is set forth in 2 CCH Federal Energy Guidelines ¶ 15,845.

U.S. obligations under the IEP. 8/ Section 708 of the Defense Production Act (DPA), 50 U.S.C app. § 2158, also provides for the formation of voluntary agreements to meet energy emergencies, and it, too, imposes certain limitations. First, only domestic voluntary agreements important to the national defense are authorized by § 708. 9/ Second, no voluntary agreement may be approved unless the Attorney General makes an affirmative finding as to its reasonableness from the standpoint of its competitive effects. See 50 U.S.C. app. § 2158(f)(1).

By contrast, proposed § 274 as currently drafted would require the Department of Justice to participate in the development, implementation, and approval of a potentially wide range of voluntary agreements and plans of action, to monitor their implementation, and to submit annual reports to the Congress and the President on their impact on competition and on small business. Most significantly, proposed § 274(f) would provide an antitrust defense for actions taken under approved voluntary agreements or plans of action. In contrast to the limitations of existing § 252 of EPCA and § 708 of the DPA, under proposed § 274 as currently drafted, agreements and plans need only be "in the public interest" and intended to "facilitat[e] preparation for, or a response to, a domestic or international energy emergency." Thus, proposed § 274 could be read to apply to actions taken under a wide variety of agreements or plans, regardless of whether they were essential to programs deemed by the Congress or the President to be in the national interest.

8/ The Energy Emergency Preparedness Act of 1982 amended § 252 of EPCA to provide that "[t]he authority granted by this section shall apply only to the development or carrying out of voluntary agreements and plans of action to implement chapters III, IV, and V of the international energy program." Pub. L. No. 97-229, § 2(b), 96 Stat. 248 (1982).

9/ The purpose of voluntary agreements authorized by § 708 is specifically "to help provide for the defense of the United States through the development of preparedness programs and the expansion of productive capacity and supply beyond levels needed to meet essential civilian demand in the United States." 50 U.S.C. app. § 2158(c).

Moreover, since proposed § 274 requires that the Department of Justice participate in the development, approval and carrying out of these agreements and plans, and further contemplates that it would amend, modify, or revoke such agreements or plans as needed, the bill would impose a substantial administrative responsibility, [10] which would require increased expenditure of limited resources. It also would impose costs on private interests that are not parties to the agreements but may be affected by them. Since approval of an agreement or plan essentially would eliminate the ability of nonparticipating entities to maintain antitrust actions to redress injuries they may suffer as a result of the implementation of such an agreement or plan, such private interests that are not parties would have to bear the costs of keeping abreast of its development and approval.

The Administration does not believe that there is a need for the broad new antitrust immunities that might be afforded by proposed § 274 as currently drafted. The antitrust laws prevent only unreasonable restraints of trade; they do not prohibit activity that enhances efficiency and is beneficial. Thus, the antitrust laws do not prohibit firms from either planning for, or responding to, energy emergencies in ways that do not have unwarranted anticompetitive effects, even where such activity involves collaboration among direct competitors.

The Department of Justice thus opposes the type of broad administrative program that might be authorized by proposed § 274, as currently drafted. The Administration believes that § 274 should be amended, primarily to make clear that it is intended to have a limited scope. The section should apply only to voluntary arrangements initiated or encouraged by the President, arrangements that he deems important to the national interest. The legislation also should make clear that such arrangements are not unreasonably or unnecessarily to interfere with competition, and that any antitrust defense arising out of § 274 will be available only in connection with voluntary agreements initiated by the President. Requirements in S. 1678 for public notice and the participation of interested persons should be retained, although they should be slightly amended to provide necessary flexibility. The bill's requirements that the Attorney General approve a plan of action only if it describes proposed substantive actions as specifically as is reasonable in light of known circumstances also should be retained. And to avoid unnecessary expenditures, mandatory monitoring and reporting requirements should be made more flexible. These and other specific suggestions regarding proposed § 274 are contained in the revised version of S. 1678 attached to this letter.

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[10] The section also contemplates an administrative role for the Department of Energy.

II. Other Amendments

The Department supports § 4(a) of S. 1678, which would extend from December 31, 1983, to June 30, 1985, the authority now granted under § 252 of EPCA with regard to the IEP, including the limited antitrust defense of § 252(f), 42 U.S.C. § 6272(f). This provision -- unlike proposed § 274 -- meets the criteria discussed above and has consistently been supported by the Department of Justice. The Departments primarily responsible for international energy policy (Energy and State) have strongly and repeatedly emphasized the Administration's commitment to, and need for, the participation of U.S. oil companies in the voluntary agreement and plan of action to assist in carrying out the allocation and information provisions of the IEP. Those provisions describe, inter alia, how oil companies are to assist IEA member governments in learning more about developments in international oil markets. They also describe how oil companies are to develop and, in the event of an oil supply disruption, to implement the emergency oil sharing system of the IEA. Our experience in monitoring industry activities strongly suggests that if the antitrust defense provided by § 252 were not available, participating U.S. oil companies might reduce or discontinue their assistance to the IEA.

Section 4(b) of S. 1678 contains four proposed amendments to § 252 of EPCA. The Department supports three of them and has no objection to the fourth. Specifically, the Department favors amending § 252(e)(2) to make the Department's rulemaking authority with regard to record-keeping under that statute optional rather than mandatory. The Department also favors amending § 252(f)(2) to include "voluntary agreement[s]," thereby correcting an apparent drafting error and allowing a new plan of action to be a document separate from a voluntary agreement. In addition, we strongly favor amending § 252(i) to require that the Department of Justice and the Federal Trade Commission produce annual rather than semiannual reports. The Department has submitted twelve reports to Congress concerning industry participation under the IEP. These reports are intended to inform Congress, the President, and the public about the activities in which oil companies are engaged under the IEP and indicate areas that might be of competitive concern. In these reports, we have consistently stated that no adverse impact on competition or small business has been discerned as a result of U.S oil company participation in these activities. In light of this experience, the Department of Justice maintains that reporting on an annual basis will not result in a significant reduction of information or analysis of industry participation in the IEP.

The Department has no objection to amending § 252(d)(3) of EPCA to alter the current requirement that a plan of action be "as specific in its description of proposed substantive actions as is reasonable in light of known circumstances," (emphasis added) by substituting the phrase "circumstances known at the time of approval." We do not believe this amendment will change existing law.

Section 5 of S. 1678 would make certain amendments to § 160 of EPCA, 42 U.S.C. § 6240, with respect to the filling and use of the Strategic Petroleum Reserve. Section 6 of S. 1678 would deal with preemption of state or local laws and regulations providing for the allocation or pricing of residual fuel products and other petroleum products, and with state set-aside programs for such products. The Department of Justice defers to those agencies more directly concerned as to whether §§ 5 and 6 should be enacted.

In sum, the Department of Justice objects to enactment of this legislation as it is now drafted, but would support enactment of more narrowly drawn legislation that includes the revisions shown on the marked version of S. 1678 attached hereto.

The Office of Management and Budget has advised this Department that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

Robert A. McConnell

Robert A. McConnell
Assistant Attorney General
Office of Legislative Affairs

Attachment

98TH CONGRESS
1ST SESSION

S. 1678

To amend the Energy Policy and Conservation Act to strengthen our Nation's energy emergency preparedness consistent with the policy set forth in section 271 of said Act, and for other purposes.

IN THE SENATE OF THE UNITED STATES

July 25, 1983

Mr. McCLURE introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

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A BILL

To amend the Energy Policy and Conservation Act to strengthen our Nation's energy emergency preparedness consistent with the policy set forth in section 271 of said Act, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE. - This Act may be cited as the "Energy Emergency Preparedness Act Amendments of ~~1983~~ 1984".

(b) TABLE OF CONTENTS. -

Sec. 1. Short title; table of contents.
Sec. 2. Congressional findings and purposes.
Sec. 3. Energy emergency preparedness organizations: executive reserves, and voluntary agreements and plans of action.

Sec. 4. International energy program amendments.
Sec. 5. Strategic Petroleum Reserve amendments.
Sec. 6. Effect on State laws.
Sec. 7. Report to the Congress.

SEC. 2. FINDINGS AND PURPOSES.

(a) FINDINGS. - The Congress finds that-

(1) legislative and administrative actions are needed to ~~strengthen-and-improve~~ continue the strengthening and improvement of our Nation's energy emergency preparedness in order to implement fully section 271 of the Energy Policy and Conservation Act (42 U.S.C. 6281), which established the policy that the Federal Government shall be prepared prior to any shortage of petroleum products to respond to energy emergencies, as a supplement to reliance on the free market to mitigate the adverse impacts of a shortage of petroleum products on public health, safety, and welfare; and

(2) individual State and local, as well as Federal, pricing and allocation of petroleum products could frustrate free market ~~price~~ pricing and allocation of available petroleum product supplies~~,-and-the-response-of-the-Federal Government-to-energy-emergencies~~.

(b) PURPOSE. - The purpose of this Act is to ~~further~~ carry out further the policy set forth in section 271(b) of the Energy Policy and Conservation Act (42 U.S.C. 6281(b)) by-

(1) amending existing energy emergency authorities to-

(A) assure that such authorities are adequate for, and remove any inconsistencies which may impede, proper implementation of the energy emergency preparedness policy established by section 271(b) of the Energy Policy and Conservation Act (42 U.S.C. 6281(b));

(B) assure the availability and effectiveness of organizations for utilizing the assistance of the private sector, including the energy emergency executive reserves, and voluntary agreements and plans of action, in ~~domestic-and-international energy-emergencies~~ energy emergencies of national or international character in order to meet ~~both~~ defense-related and non-defense-related needs;

(C) extend the expiration date of section 252(j) of the Energy Policy and Conservation Act (42 U.S.C. 6272(j)) to June 30, 1985; and

(D) preserve the ability of the domestic marketplace to work effectively in the event of a severe petroleum supply disruption by protecting against the possibility that ~~States-or-local~~ governments ~~may~~, by the adoption of ~~price~~ pricing and allocation laws, may interfere in the domestic marketplace and thereby worsen energy emergencies;

(2) ~~undertaking~~ keeping the Congress informed of appropriate administrative actions taken ~~to~~—

~~(A)-improve-and-upgrade,-on-a-timely-basis, the-comprehensive-energy-emergency-response procedures-provided-for-the-Energy-Emergency Preparedness-Act-of-1982,-by-incorporating-improvements-that-are-needed-in-light-of-the-results of-ongoing-tests-and-exercises-relating-to-the energy-emergency-response-capabilities-of-the United-States,-and~~

~~(B)~~ to assure, commensurate with the Strategic Petroleum Reserve ~~distribution-plan~~ Distribution Plan and with existing legal authorities, that-

(i) the Strategic Petroleum Reserve will be applied to meet domestic needs, including regional hardships, and can be applied to meet international obligations of the United States (including those under the International Energy ~~Agency~~ Program and NATO ~~agreements~~ Agreements); and

~~(ii)-petroleum-products-from-the Strategic-Petroleum-Reserve,-including-any such-petroleum-products-distributed-by directed-sales,-enter-the-market-during the-energy-emergency-and-are-protected from-speculation-and-hoarding,-and~~

(3) completing the Strategic Petroleum Reserve by-

(A) developing a seven hundred and fifty million barrel reserve by the end of fiscal year 1991;

(B) maintaining an average annual fill rate over the fiscal years ~~1984~~ 1985 through 1988 of at least one hundred and forty-five thousand barrels per day, with some necessary year-to-year flexibility to accommodate ~~expecially~~ especially favorable purchases that may arise in the future; and

(C) completing the Big Hill facility on a schedule that will allow fill of the facility to begin no later than the third quarter of fiscal year 1987.

SEC. 3. ENERGY EMERGENCY PREPAREDNESS ORGANIZATIONS: EXECUTIVE RESERVES, AND VOLUNTARY AGREEMENTS AND PLANS OF ACTION.

(a) Part C of title II of the Energy Policy and Conservation Act (42 U.S.C. 6281), relating to energy emergency preparedness, is amended by adding at the end thereof the following new subsections:

"ENERGY EMERGENCY EXECUTIVE RESERVES

"SEC. 273. EMPLOYMENT OF PERSONNEL; APPOINTMENT POLICIES; AND EXECUTIVE RESERVES. - (a)(1) The ~~President~~ Secretary of Energy is authorized, to the extent he deems it necessary and appropriate in order to implement the comprehensive energy emergency response procedures provided for in section 272(b), and subject to such regulations as he may issue, to train and employ persons of outstanding experience and ability without compensation in connection with the activities of the Emergency Petroleum and Gas Executive Reserve, the Emergency Solid Fuels Executive Reserve, and the Emergency Electric Power Executive Reserve of the Department of Energy.

"(2) The ~~President~~ Secretary shall be guided in the exercise of the authority provided in this subsection by the following policies:

"(A) ~~So~~ Except when there is in effect a Presidential declaration that there exists an energy emergency of national or international character, so far as possible, operations to carry out the provisions of this part shall be carried on by full-time, salaried employees of the Federal Government, and appointments under this authority shall be to advisory or consultative positions only.

"(B) ~~Appointments~~ Except when there is in effect a Presidential declaration that there exists an energy emergency of national or international character, appointments to positions other than advisory or consultative may be made under this authority only when the requirements of the position are such that the incumbent must personally possess outstanding experience and ability not obtainable on a full-time, salaried basis.

"(C) In the appointment of personnel and in assignment of their duties, the ~~President~~ Secretary shall take steps to avoid, to as great an extent as possible, any conflict between the governmental duties and the private interests of such personnel.

"(3) Appointees under this subsection shall, when policy matters are involved, be limited to advising appropriate full-time salaried Federal Government officials who are responsible for making policy decisions.

"(4) Notwithstanding any other provision of law, the ~~President~~ Secretary, upon finding that the ~~national-interest requires~~ achievement of the purpose described in section 2(b)(1)(B) of the Energy Emergency Preparedness Act Amendments of 1984 requires such action, may exempt with respect to specified activities persons who become employed pursuant to paragraph (1) from the operation of-

"(A) ~~all-Federal-laws-pertaining-to-conflict-of interest-including,-but-not-limited-to-~~

"~~(i)-sections-202-through-209-of-title-18, United-States-Code,~~

"~~(ii)-sections-201-through-211-of-title-5, United-States-Code,-appendix-I,-and~~

"~~(iii)~~ sections 601 through 608 of the Department of Energy Organization Act (42 U.S.C. 7211-7218); and

"(B) the antitrust laws (as defined in section 3(9)) or any similar State law; provided, that the exemption authorized in this subparagraph (B) shall apply only with respect to activities undertaken in good faith within the scope of the employee's official governmental duties and shall extend to the private employers of the persons who become employed pursuant to paragraph (1).

"(5) Appointments under this subsection shall be supported by written certification by the Secretary ~~of Energy~~ that-

"(A) the appointment is necessary and appropriate in order to implement the Comprehensive Energy Emergency Response Procedures;

"(B) the duties of the position to which the appointment is being made require outstanding experience and ability; and

"(C) the appointee has the outstanding experience and ability required by the position.

"(6) The Secretary ~~of Energy~~ shall publish in the Federal Register a statement including the name of the appointee, the title of his position, and the name of his private employer. The appointee shall file with the Secretary ~~of Energy~~ for publication in the Federal Register a statement listing the names of any corporations of which he is an officer, ~~or~~ director, or employee or within 60 days preceding his appointment has been an officer, ~~or~~ director, or employee or in which he owns, or within 60 days preceding his appointment has owned, any stocks, bonds, or other financial interests, and the names of any partnerships in which he is, or was within 60 days preceding his appointment, a partner, and the names of any other businesses in which he owns, or within such 60-day period has owned, any similar interest. At the end of each succeeding 6-month period, the appointee shall file with the Secretary for publication in the Federal Register a statement showing any changes in such interests during such period.

"(7) At least once every 3 months the Director of the Office of Personnel Management shall survey appointments made under this subsection and shall report his findings to the President and the Congress and make such recommendations as he may deem proper.

"(8) Persons appointed under the authority of this subsection may be allowed transportation and per diem in lieu of subsistence while away from their homes or regular places of business pursuant to such appointment, in accordance with title 5 of the United States Code.

"(b) ~~The-President~~ To achieve the purpose of section 2(b)(1)(B) of the Energy Emergency Preparedness Act Amendments of 1984, the Secretary may utilize the voluntary services of ~~Federal,~~ State~~,~~ and local agencies; ~~and-may-utilize-and-establish-such regional,-local,-or-other-agencies,-and-utilize-such-voluntary or-uncompensated-services-from-them,-as-may-from-time-to time-be-needed-to-implement-this-section,~~ and he is authorized to provide ~~by-regulation~~ for the exemption with respect to specified activities of persons whose services are utilized under this subsection from the operation of-

"(1) ~~all-Federal-laws-pertaining-to-conflict-of interest-including,-but-not-limited-to-~~

~~"(A)-sections-202-through-209-of-title-18, United-States-Code,~~

~~"(B)-sections-201-through-211-of-title-5, United-States-Code,-appendix-I,-and~~

"~~(C)~~ sections 601 through 608 of the Department of Energy Organization Act (42 U.S.C. 7211-7218); and

"(2) the antitrust laws (as defined in section 3(9)) or any similar State law; provided, that the exemption authorized in this subparagraph (2) shall apply only with respect to activities undertaken in good faith within the scope of the employee's official governmental duties and shall extend to the State and local agency employers of persons whose services are utilized under this subsection.

"(c)(1) The ~~President~~ Secretary is further authorized to provide for the establishment and training of the Emergency Petroleum and Gas Executive Reserve, the Emergency Solid Fuels Executive Reserve, and the Emergency Electric Power Executive Reserve for full-time salaried employment in executive positions in the Federal Government to assist in implementing the Comprehensive Energy Emergency Response Procedures provided for in section 272(b). ~~Members~~ For the purpose of participating in the executive reserve program, members of these executive reserves who are not at the time full-time Federal Government employees may be allowed transportation and per diem in lieu of subsistence, in accordance with title 5 of the United States Code (with respect to individuals serving without pay, while away from their homes or regular places of business)~~,-for-the-purpose-of participating-in-the-executive-reserve-training-program~~. Notwithstanding any other provision of law, the ~~President~~ Secretary, upon finding that ~~the-national-interest~~ achievement of the purpose described in section 2(b)(1)(B) of the Energy Emergency

Preparedness Act Amendments of 1984 requires such action, may exempt with respect to specified activities members of these executive reserves who become employed by the Federal Government during or in preparation for periods of ~~domestic~~ national or international energy emergency, or who are engaged in the executive reserve training program, from the operation of~~:~~

"(A) ~~all Federal laws pertaining to conflict of interest including, but not limited to:~~

"~~(i) sections 202 through 209 of title 18, United States Code,~~

"~~(ii) sections 201 through 211 of title 5, United States Code, appendix I, and~~

"~~(iii)~~ sections 601 through 608 of the Department of Energy Organization Act (42 U.S.C. 7211-7218); and

"(B) the antitrust laws (as defined in section 3(9)) or any similar State law, provided, that the exemption authorized in this subparagraph (B) shall apply only with respect to activities undertaken in good faith within the scope of the employee's official governmental duties and shall extend to the private employers of persons who become employed pursuant to paragraph (1).

"(2) The Secretary ~~of Energy~~ shall publish in the Federal Register a statement including the name of a member of these executive reserves who has become employed by the Federal Government, the title of his position, and the name of his private employer. The employee shall file with the Secretary ~~of Energy~~ a statement listing the names of any corprations of which he is an officer, ~~or~~ director, or employee or within 60 days preceding his employment has been an officer, ~~or~~ director, or employee or in which he owns, or within 60 days preceding his employment has owned, any stocks, bonds, or other financial interests, and the names of any partnerships in which he is, or was within 60 days preceding his employment, a partner, and the names of any other businesses in which he owns, or within such 60-day period has owned, any similar interest. At the end of each succeeding 6-month period, the employee shall file with the Secretary a statement showing any changes in such interests during such period.

"(d) Notwithstanding any other provision of law, ~~personnel-used-under-this-section,-including-persons-employed-without-compensation,-the-executive-reserves-and-any-members-of-the-executive-reserves-who-become-employed-by-the-Federal-Government-during-or-in-preparation-for-periods-of-domestic-or-international-energy-emergency,-or-who-are-engaged-in-the-executive-reserve-training-programs,-are-exempt-from-the-operation-of-all-Federal-laws,-rules,-and-regulations-pertaining-to-advisory-committees~~ any activities conducted under this section are exempt from the operation of all Federal laws, rules and regulations pertaining to advisory committees.

"(e) The Secretary, with the concurrence of the Attorney General, shall promulgate regulations implementing the exemptions contained in subsections (a)(4), (b) and (c)(1) of this section.

"VOLUNTARY AGREEMENTS AND PLANS OF ACTION FOR ENERGY EMERGENCIES

"SEC. 274. (a) The President is authorized to consult with representatives of the energy industry, energy consumers, and other interests, ~~with-a-view-to-encouraging-the-making-by~~ in order to initiate and encourage such persons ~~of~~ to participate in voluntary agreements and plans of action which ~~would-be-in~~ he deems important to the ~~public~~ national interest, and which in his judgment would contribute to the objectives of this part by facilitating preparation for, or a response to, ~~a-domestic-or international-energy-emergency~~ an energy emergency of national or international character in a manner that does not unreasonably or unnecessarily interfere with competition.

"(b) The President shall prescribe standards and procedures by which persons may develop and carry out voluntary agreements and plans of action provided for in subsection (a).

"(c) The standards and procedures prescribed under subsection (b) shall include without limitation the following requirements:

"(1)(A) Except as provided in subparagraph (B), meetings held to develop or carry out a voluntary agreement or plan of action under this section shall-

"(i) permit attendance by representatives of committees of the Congress and interested persons, including all interested segments of the energy industry, energy consumers, and the public;

"(ii) be preceded by timely and adequate notice with identification of the agenda of such meeting to the Attorney General, the Federal Trade Commission, committees of the Congress, and (except during an energy emergency with respect to meetings to carry out a voluntary agreement or to develop or carry out a plan of action) the public; and

"(iii) be initiated and chaired by a regular full-time employee of the Department of Energy.

"(B) The President may determine that a meeting held to carry out a voluntary agreement or to develop or carry out a plan of action shall not be open to interested persons or that attendance by interested persons may be limited, if the President finds that a wider disclosure would be detrimental to ~~the-interests-ofthe-United-States~~ achievement of the purpose described in section 2(b)(1)(B) of the Energy Emergency Preparedness Act Amendments of 1984.

~~"(C)-No-meetings-may-be-held-to-develop-or-carry out-a-voluntary-agreement-or-plan-of-action-under-this section-unless-a-regular-full-time-employee-of-the-Department-of-Energy-is-present.~~

"(2) Interested persons permitted to attend such a meeting shall be afforded an opportunity to present, in writing and orally, data, views, and arguments at such meetings, subject to any reasonable limitations with respect to the manner of presentation of data, views, and arguments as the Secretary of Energy may impose.

"(3) A full and complete record, ~~and~~ including where practicable (in order of preference) a verbatim transcript or tape recording, shall be kept of any meeting held, and a full and complete record shall be kept of any communication (other than in a meeting) made, between or among participants or potential participants, to develop or carry out a voluntary agreement or a plan of action under this section. Such record ~~or~~, transcript or tape recording shall be deposited, together with any agreement resulting therefrom, with the Secretary of Energy and shall be available to the Attorney General and the Federal Trade Commission. Such records, ~~or~~ transcripts or tape recordings shall be available for public inspection and copying in accordance with section 552 of title 5, United States Code; except that (A) matter may not be withheld from disclosure under section 552(b) of such title on grounds other than the grounds specified in section 552(b)(1), (b)(3), or so much of (b)(4) as relates to trade secrets; and (B) in the exercise of authority under section 552(b)(1), the President shall consult with the Secretary of State and the Attorney General with respect to questions relating to the foreign policy interests of the United States.

"(4) No provision of this section may be implemented so as to prevent representatives of committees of Congress from attending meetings to which this section applies, or from having access to any transcripts, records, and agreements kept or made under this section. Such access to any transcript or tape recording that is to be kept for any meeting shall be provided as soon as practicable (but not later than 14 days) after that meeting.

"(d)(1) The Attorney General and the Federal Trade Commission ~~shall~~ may participate as they deem appropriate ~~from-the-beginning~~ in the development, and when practicable, in the carrying out of voluntary agreements and plans of action authorized under this section. Each may propose any alternative which would avoid or overcome, to the greatest extent practicable, possible anticompetitive effects while achieving substantially the purposes of this part. A voluntary agreement or plan of action under this section may not be carried out unless approved by the Secretary of Energy and by the Attorney General, after consultation with the Federal Trade Commission. Prior to the expiration of the period determined under paragraph (2), the Federal Trade Commission shall transmit to the Attorney General its views as to whether such an agreement or plan of action should be approved, and shall publish such views in the Federal Register. The Attorney General, in consultation with the Federal Trade Commission and the Secretary of Energy, shall have the right to review, amend, modify, disapprove, or revoke, on his own motion or upon the request of the Federal Trade Commission or any interested person, any voluntary agreement or plan of action at any time, and, if revoked, thereby withdraw prospectively any immunity which may be conferred by subsection (f) or ~~(i)~~ (h). No approval of a voluntary agreement or plan of action under this subsection shall be subject to judicial review.

"(2) Any voluntary agreement or plan of action entered into pursuant to this section shall be submitted in writing to the Attorney General and the Federal Trade Commission at least 20 days before being implemented; except that ~~during-a domestic-or-international-energy-emergency-found-by-the-President to-exist,~~ when there is in effect a Presidentially-declared energy emergency of national or international character, the Secretary of Energy, subject to approval of the Attorney General, may reduce such 20-day period. Any such agreement or plan of action shall be available for public inspection and copying, except that a plan of action shall be so available only to the extent to which records ~~or-transcripts~~ are so available as provided in the last sentence of subsection (c)(3). Any action taken pursuant to such voluntary agreement or plan of action shall be reported to the Attorney General and the Federal Trade Commission pursuant to such regulations as may be prescribed under subsections (e)(3) and (4).

"(3) A voluntary agreement or plan of action may not be approved by the Attorney General under this subsection unless such agreement or plan-

"(A) describes the types of substantive actions which may be taken under the agreement or plan, and

"(B) is as specific in its description of proposed substantive actions as is reasonable in light of circumstances known at the time of approval.

"(e)(1) The Attorney General and the Federal Trade Commission shall monitor as they deem appropriate the development and carrying out of voluntary agreements and plans of action authorized under this section in order to promote competition and to prevent anticompetitive practices and effects, while achieving substantially the purposes of this part.

"(2) In addition to any requirement specified under subsections (b) and (c) of this section and in order to carry out the purposes of this section, the Attorney General, in consultation with the Federal Trade Commission and the Secretary of Energy, may promulgate rules concerning the maintenance of necessary and appropriate records related to the development and carrying out of voluntary agreements and plans of action authorized pursuant to this section.

"(3) Persons developing or carrying out voluntary agreements and plans of action authorized pursuant to this section shall maintain such records as are required by rules promulgated under paragraph (2). The Attorney General and the Federal Trade Commission shall have access to and the right to copy such records at reasonable times and upon reasonable notice.

"(4) The Attorney General and the Federal Trade Commission may each prescribe such rules as may be necessary or appropriate to carry out their respective responsibilities under this section. They may both utilize for such purposes and for purposes of enforcement any powers conferred upon the Federal Trade Commission or the Department of Justice, or both, by the antitrust laws or the Antitrust Civil Process Act; and wherever any such law refers to 'the purposes of this Act' or like terms, the reference shall be understood to include this section.

"(f)(1) There shall be available as a defense to any civil or criminal action brought under the antitrust laws (as defined in section 3(9)) or any similar State law in respect to actions taken to develop or carry out a voluntary agreement or plan of action (provided that such actions were not taken for the purpose of injuring competition) that-

"(A) such actions were taken-

"(i) in the course of developing a voluntary agreement or plan of action pursuant to this section, the making of which was initiated by the President, or

"(ii) to carry out a voluntary agreement or plan of action authorized and approved in accordance with this section, the making of which was initiated by the President, and

"(B) the persons taking such actions complied with the requirements of this section and the rules promulgated hereunder.

"(2) Except in the case of actions taken to develop a voluntary agreement or plan of action, the defense provided in this subsection shall be available only if and to the extent that the person asserting the defense demonstrates that the actions were ~~described~~ specified in, or within the reasonable contemplation of an approved voluntary agreement or plan of action the making of which was initiated by the President.

"(3) Persons interposing the defense provided by this subsection shall have the burden of proof upon the elements of the defense, except that the burden shall be on the person against whom the defense is asserted with respect to whether the actions were taken for the purpose of injuring competition.

"(g) No provision of this section shall be construed as granting immunity for, or as limiting or in any way affecting any remedy or penalty which may result from any legal action or proceeding arising from, any act or practice which occurred prior to the date of enactment of this section or subsequent to its expiration or repeal.

~~"(h) The Attorney General and the Federal Trade Commission shall each submit to the Congress and to the President, at least once annually, a report on the impact on competition and on small business of actions authorized by this section.~~

"~~(i)~~ (h) In any action in any Federal or State court for breach of contract, there shall be available as a defense that the alleged breach of contract was caused predominantly by action taken during ~~a domestic or international energy emergency found by the President to exist~~ a Presidentially-declared energy emergency of national or international character, to carry out a plan of action authorized and approved in accordance with this section, the making of which was initiated by the President.

"~~(j)~~ (i) Notwithstanding any other provision of law, ~~participants in voluntary agreements or plans of action, when acting~~ any activities conducted under this section, when conducted in compliance with the requirements of this section, the rules promulgated hereunder, and the provisions of the voluntary agreement or plan of action, are exempt from the operation of all Federal laws, rules, and regulations pertaining to advisory committees.

"~~(k)~~ (j) The authority provided by this section shall not apply to the development or carrying out of voluntary agreements or plans of action to implement the allocation and information provisions of the international energy program; provided, that this shall not preclude or limit the applicability of the authority to voluntary agreements or plans of action for domestic fair sharing in connection with such implementation.

(b) Section 208(b) of title 18, United States Code, relating to acts affecting a personal financial interest, is amended by striking "." in clause (2), after the word "services", and inserting in lieu thereof --

> "; or (3) if the Government official responsible for appointment of the officer or employee, with the concurrence of the Director of the Office of Government Ethics, makes a certification, published in the Federal Register, that the national interest would be served by the participation of the officer or employee because the officer or employee has outstanding qualifications not otherwise available and is acting with respect to a particular matter that requires such qualifications, and that --
>
> > "(A) the financial interest is not likely to affect the integrity of the services which the Government might expect from such officer or employee; or
> >
> > "(B) the participation by such officer or employee in the particular matter will be limited to the rendering of advice and all persons receiving such advice will be notified of the nature and extent of the officer's or employee's financial interest in the matter."

~~(b)~~ (c) CONFORMING AMENDMENTS. - Section 271 of the Energy Policy and Conservation Act (42 U.S.C. 6281) is amended-

(1) in subsection (b), by deleting "other than this part" and inserting in lieu thereof, "other than section 272".

(2) in subsection (c), by deleting "other than this part" and inserting in lieu thereof, "other than section 272, and by making available to the President authorities for utilizing the private sector in implementing this policy".

~~(c)~~ (d) The table of contents of the Energy Policy and Conservation Act is amended further by inserting after the item relating to section 272 the following:

"Sec. 273. Energy emergency executive reserves.
"Sec. 274. Voluntary agreements and plans of actions for energy emergencies.".

SEC. 4. INTERNATIONAL ENERGY PROGRAM AMENDMENTS.

(a) EXTENSION - Subsection (j) of section 252 of the Energy Policy and Conservation Act (42 U.S.C. 6272(j)) is amended by striking out "December 31, 1983" and inserting in lieu thereof "June 30, 1985".

(b) OTHER AMENDMENTS. - Section 252 of the Energy Policy and Conservation Act (42 U.S.C. 6272) is amended-

(1) in subsection (d)(1), by adding at the end thereof, "No approval of a voluntary agreement or plan of action under this subsection shall be subject to judicial review."

~~(1)~~ (2) in subsection (d)(3), by deleting "known circumstances" and inserting in lieu thereof, "circumstances known at the time of approval";

~~(2)~~ (3) in subsection (e)(2), by deleting "shall" and inserting in lieu thereof, "may";

~~(3)~~ (4) in subsection (f)(2), by inserting after "approved", the phrase "voluntary agreement or"; and

~~(4)~~ (5) in subsection (i), by deleting "once every 6 months" and inserting in lieu thereof "annually".

SEC. 5 STRATEGIC PETROLEUM RESERVES AMENDMENTS.

(a) CONFORMING AMENDMENTS. - Section 160 of the Energy Policy and Conservation Act (42 U.S.C. 6240) is amended-

(1) in subsection (c)(1)(A), by striking "500,000,000" and inserting in lieu thereof "750,000,000";

(2) by striking subsections (c)(1)(B) and (C), and inserting in lieu thereof the following:

"(B) The minimum required fill rate in any given fiscal year after fiscal year 1984 shall be 145,000 barrels per day for the purposes of subparagraph (A).";

(3) by redesignating subsection (c)(1)(D) as subsection (c)(1)(C);

(4) in redesignated subsection (c)(1)(C), striking paragraph (i), deleting "(ii)", and deleting "(C)" and inserting in lieu thereof "(B)"; and

(5) in subsection (c)(2), by striking "300,000" and inserting in lieu "145,000".

(b) CLARIFYING AMENDMENTS. - Section 161 of the Energy Policy and Conservation Act (42 U.S.C. 6241) is amended by adding the following new subsections:

"(g) Nothing in this part shall be construed to limit the authority of the Secretary of Energy to conduct sales of petroleum products stored in the Strategic Petroleum Reserve for the purposes of testing drawdown and distribution of the Reserve; such sales shall not be considered to be drawdown and distribution under this section. The receipts from such sales shall be deposited in the "SPR Petroleum Account" under section 167 and shall be subject to section 167(d).

~~"(h) The President is hereby authorized to require that performance under any contracts or orders (other than contracts of employment) which he deems necessary or appropriate to implement drawdown and distribution of the Strategic Petroleum Reserve, including service contracts, shall take priority over performance under any other contract or order, except a conflicting contract or order issued pursuant to section 101(a) of the Defense Production Act (50 U.S.C. App. 2071(a)), and for the purpose of assuring the priority transportation of Reserve petroleum products during drawdown and distribution, to require acceptance and performance of such contracts or orders in preference to other contracts or~~

~~orders by any person he finds is capable of their performance or could be made capable without an unreasonable change in that person's normal business practices,~~

"~~(i)~~ (h) Notwithstanding any other provision of law, the President may permit any crude oil withdrawn and sold from the Strategic Petroleum Reserve in accordance with the provisions of this section to be exported to any country pursuant to an arrangement for the delivery of refined petroleum products to the United States.".

SEC. 6. EFFECT ON STATE LAWS.

(a) Part C of title II of the Energy Policy and Conservation Act, relating to energy emergency preparedness, is further amended by adding at the end thereof the following new section:

"EFFECT ON STATE LAWS

"SEC. 275. ~~(a) PREEMPTION.— (1) Except as provided in paragraph (2) and subsection (b), any law or regulation adopted or promulgated by a State or any political subdivision thereof, to the extent that such law or regulation provides for the pricing or allocation of residual fuel oil or any other petroleum product, is hereby preempted.~~

"~~(2) The President may, by rule or order, exempt from the operation of paragraph (1) classes or categories of laws or regulations, or specific laws or regulations, which would otherwise be preempted under paragraph (1), to the extent that the President determines that such laws or regulations would~~

"~~(A) preserve a significant State or local interest;~~

"~~(B) not unduly burden interstate commerce; and~~

"~~(C) not interfere with the policy established by section 271.~~ When a declaration by the President is in effect that there exists an energy emergency of national or international character, he periodically shall assess whether the adoption of petroleum product pricing or allocation laws by States or political subdivisions thereof interferes or is likely to interfere in the domestic marketplace in such a manner as to worsen the energy emergency nationally and unduly burden interstate commerce. If the President concludes that such interference is occurring or is likely to occur, he may specify, individually or by classes or categories, any or all laws or regulations adopted by States or political subdivisions thereof (except for set-aside programs approved pursuant to subsection (b)) which in his judgment require preemption, and those laws and regulations shall be preempted from the time he so specifies, to the extent that they provide for the pricing or allocation of petroleum products. The President from time to time, in his discretion, may revise the list, classes or categories of preempted laws or regulations, and shall terminate in whole or in part the preemption of such laws or regulations when he finds that they no longer would worsen the energy emergency nationally and unduly burden interstate commerce.

"(2) No action of the President under paragraph (1) shall be subject to judicial review.

"(b) STATE SET-ASIDE. - The Governor of any State may notify the President of the Governor's intent to implement, under State law and in accordance with the requirements of this subsection, a State set-aside program for ~~residual-fuel-oil-or~~ any ~~other-refined~~ petroleum product.

"(2) For purposes of this subsection, the term 'State set-aside program' means with respect to ~~residual-fuel-oil-or~~ any ~~other-refined~~ petroleum product, a program administered by the State under State law and which-

"(A) is implemented only upon a determination by the Governor that the program is required to meet a petroleum product supply shortage within the State which will significantly impair essential public services or essential economic activity;

"(B) continues in effect for no more than 90 days;

"(C) authorizes the Governor to require a prime supplier of ~~residual-fuel-oil-or~~ any ~~other-refined~~ petroleum product subject to the program to set aside in any month a volume of such ~~residual-fuel-oil-or-other-refined~~ petroleum product for distribution under the program which volume does not exceed 5 percent of the total supply, as estimated by such supplier, of such ~~residual-fuel-oil-or-other-refined~~ petroleum product which will be sold by the supplier in the State for consumption within the State in that month;

"(D) defines a prime supplier as a supplier which makes the first sale of that ~~residual-fuel-oil-or-other refined~~ petroleum product subject to the State set-aside into the State distribution system for consumption within the State;

"(E) does not authorize the Governor to fix or limit the price of any petroleum product which is set aside; and

"~~(B)~~ (F) does not unduly burden interstate commerce.

"(3)(A) The Governor shall provide the President with notice under paragraph (1), accompanied by a request for approval of the State set-aside program the Governor intends to implement, at least 10 days prior to the date on which the Governor intends to implement the program.

"(B) Within 10 days after receipt of such notice and request transmitted by the Governor, the President ~~shall~~, in his discretion, shall either approve or disapprove such request and notify the Governor of the President's action.

"(C) To the extent that the President approves the request within such 10-day period, the program shall then be exempt from the operation of subsection (a).

"(D) If the President does not approve such request within such 10-day period, the request shall be considered disapproved and the program shall not be exempt under this subsection from the operation of subsection (a).

"(E) The President's approval of any program under this subsection may be in whole or in part, but only so much of any State set-aside program as the President approves under this paragraph may be implemented.

"(4) Notwithstanding the 90-day limitation in paragraph (2)(B), an exemption under this subsection allowing implementation of any State set-aside program may be extended by the President for successive 90-day periods if the Governor transmits a notice and request therefor to the President and the President approves such request prior to the expiration of the applicable 90-day period. For such purposes, the preceding provisions of this subsection shall apply with respect to any notice and request for such an extension as if it were for exemption for initial implementation.

"(5) Any approval or disapproval by the President of a request under paragraph (3) or (4) shall not be subject to judicial review.

"(c) PROTECTION OF CERTAIN INVENTORIES. - (1) ~~Notwithstanding subsection (b), no~~ No State shall have authority to-

"(A) provide for the allocation of consumer petroleum product inventories,

"(B) impose restrictions on the consumption of such inventories, or

"(C) consider or take into account the existence or size of such inventories in determining the amount of petroleum products to be allocated to any such consumer.

"(2) For purposes of paragraph (1)-

"(A) The term 'consumer petroleum product inventory' means an inventory of ~~residual-fuel-oil-or-other-refined~~ petroleum products which ~~is~~-

~~"(i)-held-by-and-in-the-custody-of~~ is owned by a consumer (other than a refiner, except to the extent provided in subparagraph ~~(C)~~ (B) for such consumer's own end-use consumption~~,~~.

~~"(ii)-held-by-and-in-the-custody-of-such-consumer-on-the-day-before-the-date-on-which-a State-set-aside-program-is-implemented,-and~~

~~"(iii)-not-thereafter-sold-by-such-consumer, but-only-to-the-extent-that-such-inventory-does not-exceed-the-inventory-of-residual-fuel-oil-and refined-petroleum-products-held-by-and-in-the-custody-of-that-consumer-for-its-own-end-use-consumption-on-the-30th-day-prior-to-the-date-of such-implementation,~~

~~"(B)-The-term-'held-by-and-in-the-custody-of', when-used-with-respect-to-an-inventory,-means-any such-inventory-owned-by-the-consumer-and-in-the direct-possession-of-the-consumer,-such-as-on-the-consumer's-site,~~

"~~(C)~~ (B) The term 'end-use consumption', in the case of an inventory of ~~residual-fuel-oil-or-other-refined~~ petroleum products of any consumer which is a refiner, means the use by the refiner of such ~~residual-fuel-oil-or other-refined~~ petroleum products to meet normal fuel requirements necessary for operating refinery equipment and facilities.".

(b) CONFORMING AMENDMENTS. - Section 271 of the Energy Policy and Conservation Act is amended-

(1) in subsection (a)(2), by deleting "and";

(2) in subsection (a)(3), by deleting the period and inserting in lieu thereof a semicolon and the word "and";

(3) in subsection (a), by adding the following new paragraph:

"(4) individual State and local, as well as Federal, pricing ~~or~~ and allocation of petroleum products could frustrate free market pricing and allocation of available petroleum supplies~~,-and the-response-of-the-Federal-Government-to-energy emergencies~~."; and

(4) in subsection (c), by inserting after, "than this part", a semicolon and "further, by preventing individual ~~State-and-local~~ petroleum product pricing or allocation laws or regulations from interfering with the carrying out of this policy.".

(c) The table of contents of the Energy Policy and Conservation Act is amended by inserting after the new item relating to section 274 the following:

"Sec. 275. Effect on State laws.".

(a) The Energy Emergency Preparedness Act of 1982 is amended by adding at the end thereof the following new section:

"SEC. 7. REPORT TO THE CONGRESS.

"(a) The Secretary of Energy ~~shall undertake, pursuant to authorities otherwise available under existing law, additional actions necessary to strengthen and improve our Nation's energy emergency preparedness in order to implement fully the policy established by section 271(b) of the Energy Policy and Conservation Act (42 U.S.C. 6281(b)). The Secretary~~ shall report, as specified in subsection (b), to the Congress on any ~~such~~ actions taken~~, including, but not limited to, measures~~ to-

~~"(1) improve and upgrade on a timely basis, the comprehensive energy emergency response procedures provided for by section 272(b) of the Energy Emergency Preparedness Act of 1982 (42 U.S.C. 6282(b)) by incorporating improvements (including improvements in Department of Energy organization, interagency coordination, decisionmaking procedures, and emergency alert systems and logistics support) that are needed in light of the results of ongoing tests and exercises relating to the energy emergency response capability of the United States,~~

"~~(2) assure the availability and effectiveness of organizations for utilizing the assistance of the private sector, including the energy emergency executive reserves, and voluntary agreements and plans of action, in domestic and international energy emergencies in order to meet both defense related and non-defense related needs,~~

"~~(3) preserve the ability of the domestic marketplace to work effectively, in the event of a severe petroleum supply disruption, by protecting against the possibility that States or local governments may, by the adoption of price and allocation laws, interfere in the domestic marketplace and thereby worsen energy emergencies,~~

"~~(4)~~ (1) assure, commensurate with the Strategic Petroleum Reserve Distribution Plan and with existing legal authorities, that-

"(A) the Strategic Petroleum Reserve will be applied to meet domestic needs (including regional hardships) and can be applied to meet international obligations of the United States (including those under the International Energy Agency Program and North Atlantic Treaty Organization ~~agreements~~ Agreements); and

"(B) petroleum products from the Strategic Petroleum Reserve, including any such petroleum products distributed by directed sales, enter the market during the energy emergency and are protected from speculation and hoarding; and

"~~(5)~~ (2) complete the Strategic Petroleum Reserve by-

"(A) developing a 750 million barrel Reserve by the end of fiscal year 1991;

"(B) maintaining an average annual fill rate over the fiscal years ~~1984~~ 1985 through 1988 of at least 145,000 barrels per day, with some necessary year-to-year flexibility to accommodate especially favorable purchases that may arise in the future; and

"(C) completing the Big Hill facility on a schedule that will allow fill of the facility to begin no later than the third quarter of fiscal year 1987.

"(b) ~~Within 3 months~~ In the next quarterly Strategic Petroleum Reserve report required under subsection 165(b) of the Energy Policy and Conservation Act after the date of enactment of this section, and annually thereafter in the annual Strategic Petroleum Reserve report required under subsection 165(a) of that Act, the Secretary of Energy shall ~~submit a~~ report to the Congress ~~containing a description of~~ on the actions taken pursuant to subsection (a) ~~and any other actions taken to strengthen and improve our Nation's energy emergency preparedness in order to further carry out the policy set forth in section 271(b) of the Energy Policy and Conservation Act (42 U.S.C. 6281(b))~~.".

APPENDIX IV

Additional Statements Submitted for the Record

STATEMENT OF

EUGENE P. BYARS
GENERAL MANAGER - ELECTRIC SYSTEM OPERATIONS
ALABAMA POWER COMPANY
AREA DIRECTOR - EMERGENCY ELECTRIC POWER EXECUTIVE RESERVE
for the
SOUTHEASTERN ELECTRIC RELIABILITY COUNCIL

Regarding Senate Bill S. 1678

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

OCTOBER 19, 1983

This statement is submitted on behalf of the Edison Electric Institute (EEI). EEI is the association of investor-owned electric utilities. Its members serve over 67 million customers and provide 78 percent of the nation's electricity. It should also be mentioned that the views presented here are consistent with those of the nine operating regions of the North American Electric Reliability Council (NERC) as well as the Southeastern Electric Reliability Council (SERC).

The electric utility industry commends Chairman McClure and his committee for their interest in emergency preparedness and the continuing efforts to upgrade our country's ability to deal effectively with national energy-related emergencies. The volatile world situation continues to pose a threat of an imported oil supply shortfall for our country. It is our opinion that the Strategic Petroleum Reserve program is very important to the future economic well being of our nation.

Certain provisions of Senate Bill S. 1678 do, however, raise serious concerns within the electric utility industry. First, we wish to assure you that the electric utility industry has actively supported federal efforts to plan and prepare for a national electric emergency since the mid-1950's. Our industry demonstrated enlightened leadership in voluntarily formalizing with the Federal Government an Industry Advisory Group comprised of Chief Executive Officers and a potent field organization designed specifically to respond to the nation's projected electric power needs in the event of a declared national emergency. This organization was an active and highly regarded organization until the 1970's when the Federal Advisory Act and the Department of Energy Organization

Act as well as certain antitrust laws and financial disclosure requirements, in effect, clouded the emergency preparedness issue, to the extent that the Industry Advisory Group was dissolved. Today, the electric industry remains concerned as to its participation in emergency preparedness activities and fully supports an effective resolution of the conflict-of-interest and antitrust constraints regarding emergency preparedness.

The most serious concern that our industry has with S. 1678 is the unlimited scope of the provisions. We are vitally concerned that the broad,all-inclusive language under Section 2 (b) (1) (B) and Section 3, Subsections 273 and 274 subjugate the managerial prerogatives of our industry to federal control during less-than-national emergency events. The electric utility industry has repeatedly demonstrated its capacity for dealing with non-defense or less-than-national emergency events and strongly believes that it can continue to handle such emergencies in the future without additional federal controls. Under the Defense Production Act (DPA), these authorities were linked to the needs of national defense or of national defense preparedness programs. In the Energy Security Act of 1980, Congress specifically designated energy as a strategic material within the meaning of the DPA's Declaration of Policy and added language to emphasize that preparedness programs as well as actions to expand productive capacity and supply in order to assure the availability of energy supplies are linked to the national defense. With this linkage specifically delineated, our industry continues to support the limitation of these provisions to defense-related or national security related emergencies. This bill, however, will group short-term local or regional emergencies with a state of war, with utility employees limited to advising appropriate full-time, salaried Federal Government officials.

As noted in the Preamble of the Charter of the former Industry Advisory Committee "electric utilities, because of their obligations to provide reliable electric service to the public, are well-equipped to cope with most emergencies." This is true regardless of whether the disturbance is initiated by weather or sabotage. People operating electric utilities are intimately familiar with the status of their facilities and equipment, the availability of emergency power from interconnections, access to law enforcement agencies where criminal acts are suspected, the best sequences for restoring interrupted service, the availability of spare equipment such as transformers from other utilities, etc. It is our opinion that decisions in the event of a widespread electric emergency must be made rapidly by individuals with an in-depth knowledge of integrated electric power system operations. Unless national security is involved, federal government interaction should be limited.

The provisions of S. 1678 which includes EEPER, if enacted, would destroy a time-tested plan for managing strategic materials and coordinating available electric energy supplies which has long been supported by our industry. It would support instead, a Federal bureaucracy through which persons with no current utility experience would make the crucial decisions. We believe that Federal involvement should be directed toward coordinating effective planning for maintaining power supply in the wake of a military attack on the United States or in the event of a major national fuel shortage or cutoff if national security is threatened.

Finally, certain sections of the bill provide heavy constraints on meetings held to discuss, develop, or carry out a voluntary agreement or plan of action as to attendance, notification, initiating, and chairing of such meetings. Meetings and working sessions such as these must be held in an atmosphere which promotes free and open discussion with latitude to discuss and explore multiple plans and alternatives, many of which will be discarded after full discussion. The requirement for open meetings will seriously inhibit the productivity of these essential discussions. Furthermore, the required involvement of various groups may raise extraneous issues and, consequently, be detrimental to effective emergency preparedness planning. Again, we wish to reiterate that the broad scope of this bill authorizes these activities for domestic energy emergencies without qualification. Our electric utility industry planners and operators meet regularly to discuss, plan, and agree on courses of action to minimize electric system emergencies and to mitigate the impact if an electric system emergency occurs. It is surely not the intent of this bill to constrain the electric utility industry from holding such meetings and making such plans or agreements to cope with electric system emergencies; however, the language of the bill as written clearly raises this issue.

We appreciate the opportunity to present our views on this important national security matter. The electric utility industry stands ready to assist the Congress in preparation for clearly defined national energy emergencies.

Comments Submitted to
THE SENATE COMMITTEE
on ENERGY AND NATURAL RESOURCES
Regarding
S. 1678, THE ENERGY EMERGENCY PREPAREDNESS ACT AMENDMENTS of 1983

For the Record of the Hearing on October 19, 1983

The American Independent Refiners Association ("AIRA") was established to represent the interests of the independent refining industry and to unify the independent refiners' voice in Washington. AIRA appreciates this opportunity to submit comments on S. 1678, the Energy Emergency Preparedness Act Amendments of 1983, and on the issue of energy emergency preparedness.

With this statement, AIRA first will offer general comments regarding energy emergency preparedness and the drawdown of the Strategic Petroleum Reserve ("SPR") and then will address in detail several specific aspects of S. 1678. Generally, AIRA is concerned that S. 1678 does not address weaknesses in current federal policy, particularly as it is implemented by the SPR Drawdown and Distribution Report of December 1, 1982 (Plan Amendment No. 4). Further federal action and planning are necessary to assure achievement of the basic objective of speeding the delivery of vital petroleum supplies to adversely affected sectors of the nation in the event of a supply disruption.

I. General Comments and Recommendations Regarding Energy Emergency Preparedness and the Current Strategic Petroleum Reserve Drawdown Plan

Independent refiners are, by definition, those firms that neither own nor control a significant proportion of the crude oil production necessary to operate their facilities at rated capacities. They must purchase the majority of their crude oil needs for refining in arms-length transactions from domestic producers, foreign governments or international trading companies.

The number of independent refineries currently operating in the United States is roughly half that of the late 1970's. Typically, the sixty to seventy independent refiners still effectively operating today have survived in a declining petroleum market because their facilities are efficient and well managed, and often because they manufacture certain speciality products or serve distinct regional product markets. These independent refiners and the customers they serve are among the most vulnerable to another petroleum embargo. Thus, AIRA's members are particularly aware of the importance of the SPR and believe that any drawdown should be designed to facilitate access to SPR petroleum for refineries most affected by a crude oil supply interruption, and not merely for those potential purchasers which have the greatest financial resources.

AIRA's members believe that federal policy as implemented by the SPR drawdown plan now in effect has certain fundamental shortcomings. The plan provides that SPR oil will be sold by price competitive sale with awards going to the highest bidders, and does not include adequate procedures to assure that petroleum supplies, at a fair price, will reach those product markets and regions of the country most hurt by serious disruptions. There is a provision to reserve "under the most extreme circumstances" the distribution of up to 10 percent of the total volume of SPR oil sold in any calendar month in such a manner as the Secretary of the Department of Energy ("DOE") determines is proper. However, the price for such oil would be the average price of SPR oil sold at a contemporaneous competitive sale, or at the most recent competitive sale if no contemporaneous competitive sale is held. Such a provision is of limited assistance to crude deficient independent refiners because, first, the price would be virtually identical to the price at the open auction — which is likely to be extremely high. Second, the volume of SPR crude oil available under "extreme conditions" is woefully inadequate, and probably would have only marginal utility for a few independent refiners because it would make available far less petroleum than is necessary for independents to economically operate their facilities.

Not only is there inadequate provision for suspending the auction approach, but participation in the auction system, as DOE is now approaching it, is totally unrestricted. Purchase offers for any volume may be submitted by any party which has sufficient financial resources, and thus the system is prone to dominance and manipulation. The current plan does not provide for consideration of factors such as consumer need in the determination of the amount of crude oil a single purchaser can buy, and it places no limit upon the price a purchaser must pay. In an emergency, the SPR petroleum could become one of the highest cost sources of supply in a period of rapidly inflating prices and SPR petroleum could be beyond the reach of most independent refiners.

In the event of a disruption, in order to fulfill their commitments to the customers they serve and to assure their own short-term survival, independent refiners could be forced to replace lost supply by bidding aggressively for a diminishing volume of uncommitted crude, including SPR oil. The limited capital resources of most independent refiners could restrict their ability to compete for SPR oil. Although the major integrated companies, like independent refiners, would incur increased marginal costs associated with spot market and SPR crude oil purchases, because of their substantial proprietary production the majors would be able to keep their average product prices at less than the fair market value of petroleum products refined entirely from spot market and SPR crude. At the same time, the majors would be able to use their crude oil and natural gas reserves as collateral to meet their financing requirements.

The current plan permits even foreign purchasers to bid against United States companies for the purchase of SPR oil. Theoretically, and assuming compliance with relevant export limitations, the reserve dedicated to the supply of energy to American consumers during an emergency could be used even for the benefit of nations responsible for the problems underlying the emergency declaration.

The basic weaknesses of the current SPR drawdown plan would be exacerbated by the standard sales provisions recently proposed by DOE for implementation in the event of a sale of SPR crude oil (48 Fed. Reg. 27482, June 15, 1983). The proposed sales provisions are extraordinarily harsh and appear to be designed not to address emergency conditions but rather to assure that the federal government becomes the most profitable petroleum supplier if an emergency does occur. The expensive and inflexible sales procedures would be troublesome to all potential purchasers in that they are inconsistent with established commercial practices, but compliance would be easiest for well financed, geographically diversified major oil companies, particularly those with greatest access to transportation facilities. The procedures would be disproportionately burdensome to independent refiners with relatively limited financial strength and flexibility in crude and transportation scheduling. The sales procedures could cause emergency conditions to worsen by casting the federal government in the role of price leader, while at the same time placing SPR petroleum beyond the reach of those refiners most likely to be hurt by the emergency.

While AIRA's members acknowledge the efficiency of the market mechanism in distributing crude oil during periods of adequate supply, they believe that an unrestricted market auction under emergency conditions could result in an unequal distribution of the burden caused by the emergency in the short run, and in serious supply problems for the nation's economy in the long run. AIRA's members believe that a better system would mandate the rational allocation of SPR crude oil in severe situations to those refiners whose supply actually has been disrupted.

Customers of independent refiners, including those in isolated regions of the nation, have a particular interest in seeing that the refineries which supply their needs are not stampeded during an unrestricted emergency auction of SPR oil. It is unlikely that, in an emergency, successful SPR crude purchasers would seek to expand into markets served by crude-deficient independent refiners while at the same time struggling to serve their existing markets. If the customers of independent refiners were unable to bid for SPR crude oil and thus forced to close, the ultimate result could be intense public pressure for a system which would be far more administratively burdensome for everyone. If customers were left without fuel, political pressures could ultimately result in chaos growing from a hastily developed fuel rationing system.

The grant of authority in Section 161 of the Energy Policy and Conservation Act ("EPCA") is broad enough to permit DOE to develop an allocation system and sales procedures capable of assuring that SPR crude oil reaches industry sectors and geographic areas hardest hit by a severe supply interruption. However, as demonstrated by the current drawdown plan, by the proposed standard sales provisions and by other public statements, the Administration is clinging to its free market approach and is declining to make plans which would realistically address emergency conditions.

It would be appropriate for Congress to direct the Administration to move away from the strict auction approach and to develop a realistic system for allocating fairly priced crude oil to domestic refiners in the event of a severe energy emergency. It also appears necessary for Congress to remind the Administration that Section 271(b) of the EPCA requires the Federal government to "be prepared prior to any shortage of petroleum products to respond to energy emergencies...as a supplement to reliance on the free market." While S. 1678 would reiterate current Congressional policy in support of energy emergency preparedness, the bill falls short of directing the Administration to take specific steps to assure that the nation actually will be ready to deal with a severe energy emergency.

II. Additional Specific Recommendations Regarding S. 1678

A. SPR oil should be sold only to domestic refiners

To fulfill the objective of diminishing United States vulnerability to the effects of a severe energy supply interruption (and except as may be required by the International Energy Program), S. 1678 should be amended to direct DOE to sell SPR crude oil only to firms which are (1) domestic and (2) actively engaged in refining. Furthermore, refiners should not be permitted to purchase volumes of crude oil in excess of their refining capacity.

United States refiners are best situated to assure that supplies of petroleum products reach affected American consumers as quickly as possible. To allow other than domestic companies to compete for the nation's scarce emergency reserves is contrary to the basic goal of energy independence. And to permit third party brokers to compete for crude oil during emergency situations is inconsistent with the goal of discouraging speculation and hoarding and will exacerbate the delays and crude oil price inflation inherent in the emergency conditions. Refiners should be permitted, consistent with standard practice, to work with brokers and traders to facilitate efficient delivery of crude supplies to appropriate refineries. However, DOE should not accept offers from third party brokers and traders -- whose participation as purchasers could result in additional time-consuming and inflationary steps -- but rather should sell SPR crude oil only to refiners actually able to process a barrel of crude oil for every barrel of SPR oil which they purchase.

B. DOE should be directed to expand and clarify the 10-percent directed sales provision

The ten percent of SPR crude oil, which, under the current drawdown plan, would be available under extreme conditions for distribution by some method other than a strict auction system, is an insufficient volume of crude to meet the needs of independent refiners and their customers. DOE should be directed to make available a far greater volume of SPR crude oil for distribution through an allocation system which takes into account factors such as consumer needs, competitive impacts, and prevailing refining and distribution patterns. At the very least, DOE should be directed to undertake a public proceeding to establish the details for the 10-percent set-aside for which the current plan provides.

C. Congress should prohibit the export to other countries of any crude oil withdrawn from the SPR

AIRA opposes and its members are deeply concerned about the provision within Section 5(b) of S. 1678 whereby the President could permit crude oil withdrawn from the SPR to be exported to any country in exchange for imports of petroleum products. This provision is anticompetitive and inconsistent with the goal of U.S. energy independence. It would mean that during an emergency SPR oil could be shipped abroad to the facilities of foreign refiners and international major oil companies, even while independent domestic refiners are going out of business because they are unable to secure crude oil supplies. The net long term effect would be to encourage the export of U. S. refining capacity to other nations, at the expense of the domestic refining industry, and thus to increase the nation's vulnerability to future supply disruptions.

D. Congress should mandate an annual SPR fill rate of at least 186,000 barrels per day

S. 1678 calls for completion of the SPR by maintaining an average annual fill rate over fiscal years 1984 through 1988 of at least 145,000 barrels per day. AIRA does not support this proposal for a reduced fill rate. The rate of 220,000 barrels per day currently mandated by the EPCA is more consistent with the goal of strengthening the nation's energy emergency preparedness. At the very least, S. 1678 should be amended to mandate a fill rate of at least 186,000 barrels per day, as established for the next two years by the recent Department of Interior appropriations bill.

E. Congress should mandate a test drawdown, distribution and sale of SPR crude oil

Although test sales of SPR crude oil can not truly approximate emergency conditions, they might provide a way to gather information about some of the weaknesses in the existing plan. AIRA supports the language in Section 5(b) of S. 1678 clarifying that DOE's authority to conduct test sales of SPR crude oil would not be limited by the bill. AIRA also would support an amendment to S. 1678 which could go further, and would require that DOE perform, perhaps periodically, a test drawdown, distribution and sale of SPR crude oil.

STATEMENT BY

CHEVRON U.S.A. INC.

For the Hearing Record

- On S. 1678 -

"A BILL to amend the Energy Policy Conservation Act to strengthen our nation's energy emergency preparedness consistent with the policy set forth in Section 271 of said Act, and for other purposes."

SENATE ENERGY COMMITTEE

Hearing Of

October 19, 1983

Washington, D.C.

We are supportive of the general thrust of this legislation. We have specific recommendations which we believe would render the legislation more uniformly consistent with existing statutes, and with what we perceive as congressional intent to improve our nation's response to energy emergencies.

SEC. 3 ENERGY EMERGENCY PREPAREDNESS ORGANIZATIONS: EXECUTIVE RESERVES, AND VOLUNTARY AGREEMENTS AND PLANS OF ACTION.

This section seeks to assure the availability and effectiveness of government organizations by utilizing the assistance of the private sector. Its provisions would apply to both domestic and international emergencies, and to both defense-related and non-defense-related needs. The specified private sector areas are identified as:

- Energy emergency executive reserves;
- Voluntary agreements and plans of action.

Thus, Section 3 would amend Part C of title II of the Energy Policy and Conservation Act (42 U.S.C. 6281) by adding at the end thereof, new Sections 273 and 274.

Legal Exemptions

Subsections (a)(4), (c)(1) and (d) of Section 273 provide that the President may exempt persons who become employed by the Federal Government - pursuant to Section 273 -from the operation of Federal laws, rules, and regulations pertaining to advisory committees. The exemptions do not specifically cover such person's permanent employers.

Recommended Addition

We believe it is appropriate to also specifically exempt such permanent employers from the operation of such laws in respect of the activities of their employees while on loan to the Federal government.

Anti-Trust Exemption/Defense

For purposes of the antitrust exemption provided for under Section 273 and the antitrust defense provided for under Section 274, "antitrust laws" are defined as Federal antitrust laws. However, in the Energy Policy and Conservation Act (EPCA), Section 252 (f)(1) specifically provides that the antitrust defense for international allocation includes state antitrust laws.

Recommended Addition

We believe it is appropriate to redefine "antitrust laws" in Section 274 (f)(1) to include state antitrust laws. This addition would help protect employees on loan to the government, and to protect their permanent employers.

PLAN OF ACTION

Section 274 (d)(3)(B) provides that a plan of action may not be approved by the Attorney General under such subsection unless such plan "is as specific in its description of proposed substantive actions as is reasonable in light of circumstances known at the time of approval." This is substantially the same as the requirement contained in Section 252 (d)(3)(B) of EPCA, which governs voluntary agreements and plans of action to implement the allocation and information provisions of the International Energy Program (IEP).

Recommended Modification

We believe this "specificity" requirement in Section 274 (d)(3)(B) of the present bill, and in Section 252 (d)(3)(B) of EPCA from both a practical and legal standpoint is unnecessarily detailed, and should be deleted. Such deletion would then allow the drafting of plans of action–covering actions by companies to implement the emergency allocation system - which are more general in nature.

In Section 274 (i) we recommend that "voluntary agreement or" be inserted (in line 7 on page 20) before "plan of action."

VOLUNTARY AGREEMENTS/PLANS OF ACTION

Section 274 (k) provides:

> "The authority provided by this section shall not apply to the development or carrying out of voluntary agreements or plans of action to implement the allocation and information provisions of the international energy program."

We assume Congress does not intend to exclude voluntary agreements or plans of action which would implement "fair sharing" in support of the United States' obligation under the IEP. We favor domestic fair sharing in support of the IEP and believe that appropriate federal authority for it should be retained in U.S. energy legislation.

Subsection (k) may have been phrased in such a way so as to be consistent with Section 252 (a) of the EPCA which provides that the requirements of that section shall be the sole procedures applicable to the development and carrying out of voluntary agreements and plans of action to implement the allocation and information provisions of the International Energy Program.

Recommended Modification/Clarification

We believe it is advisable that Section 274 (k) be modified to make clear that this section covers voluntary agreements or plans of action providing for domestic fair sharing in support of the U.S.'s obligations under the International Energy Program. If this is not possible, the legislative history of this section should make clear that this is the intent.

SEC. 4 INTERNATIONAL ENERGY PROGRAM AMENDMENTS.

Section 4 of the present bill proposes amendments to Section 252 of the EPCA (see pages 21-22). This also relates to Section 274(d)(3)(B), discussed above, concerning a "plan of action."

We believe the drafting of plans of action to be an essential activity, and one which helps ensure the successful implementation of an emergency allocation system. By necessity this activity should be flexible, and often broad in scope. The limitations posed by existing law in "specificity" provisions will work to inhibit and restrict planning activity in the drafting of plans of action.

Recommended Changes

Thus, we recommend the entire deletion of Section 252(d)(3)(B) in the EPCA. (This section requires that a plan of action be "as specific" in its description of proposed substantive actions as is reasonable in light of known circumstances).

We recommend insertion, at the end of the first sentence in Section 252(c)(3) of the EPCA:

> **", except that during an international energy supply emergency found by the President to exist, the Attorney General, in consultation with the Federal Trade Commission and the Administrator, may modify or waive such recordkeeping requirements."**

SEC. 6 EFFECT ON STATE LAWS

We strongly endorse the explicit Federal preemption of State pricing and allocation laws. We concur in the establishment of Federal guidelines for state set-aside programs. In this regard, we believe the bill under consideration should furnish definite guidelines. The objective of more complete guidelines would be to achieve broad consistency among state programs while providing a mechanism by which states may tailor their programs to meet their specialized needs.

Recommended Additions

Accordingly, we recommend certain provisions be stipulated for any state plans which seek Presidential exemption from Section 275(a) of the present bill.

These provisions could be incorporated under Section 275(b), and are the following:

- Set-aside volumes should be provided for end-users only. Priority users, hardship cases, and other authorized recipients of set-aside volumes should be clearly defined.

- A three (3) percent ceiling on set-aside volumes should be established, to avoid the withholding of unnecessarily large volumes of product from the market (page 25, line 21).

- Each state program should include a process for appeal of the decision of the agency administering the program.

- State's set-aside orders to supply particular customers should be, on a first-preference, directed to the customer's historical supplier.

- The successive extension by the President of any state set-aside program should be limited to 30 days at a time.

- The President should have explicit authority to terminate set-aside programs upon his determination an energy emergency no longer exists.

SEC. 7 REPORT TO THE CONGRESS

We agree that the Strategic Petroleum Reserve should be available to the President to respond to international obligations of the United States.

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Maine
New Hampshire
Vermont
Massachusetts
Rhode Island
Connecticut
New York
New Jersey
Pennsylvania
Delaware
Maryland
Virginia
Washington, D. C
North Carolina
South Carolina
Georgia
Florida

COMMENTS

of the

INDEPENDENT FUEL TERMINAL OPERATORS ASSOCIATION

on the

"ENERGY EMERGENCY PREPAREDNESS ACT AMENDMENTS OF 1983"

before the

COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

October, 1983

The Independent Fuel Terminal Operators Association ("IFTOA") hereby submits comments on S. 1678, the "Energy Emergency Preparedness Act Amendments of 1983." As the Chairman and Committee are aware, our Association has, since 1973, worked closely with the Congress in efforts to deal with severe petroleum supply disruptions. Two years ago we strongly supported S. 1503 and believed that the veto of that legislation was a serious mistake.*/ Moreover, we do not agree with the Administration's sole reliance on the "free market approach" during a crisis; while under normal circumstances the market is the most efficient allocator of products, it cannot adjust fast enough during the early days of a crisis to avert most hardships. Thus, complete reliance on the market will result in supply dislocations and escalating prices. While S. 1678 does not go far enough to mitigate significantly the hardships that would occur at the beginning of a substantial shortage, it represents some progress.

IFTOA is an association composed of 16 companies which operate deepwater oil terminals along the East Coast from Maine to Florida.**/ None is affiliated with a major oil company. Members are primarily marketers of residual fuel oils (Nos. 4, 5 and 6 fuels) and home heating oil (No. 2 fuel); several companies also market significant volumes of gasoline at wholesale and retail levels. Members handle nearly 50% of the non-utility residual fuel oil shipped to the East Coast, nearly 60% of the non-utility residual fuel oil shipped to New England, 25% of the No. 2 heating oil shipped to the East Coast, and more than 50% of the No. 2 heating oil shipped to New England.

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*/ See Statement of the Independent Fuel Terminal Operators Association on "Energy Emergency Preparedness" before the Committee on Energy and Natural Resources, United States Senate, Washington, D.C. (July 30, 1981). A copy of that statement is attached.

**/ A list of members and description of the Association is attached. (Attachment A).

I. Effect on State Laws

A. Preemption

Section 6 of S. 1678 would preempt any state or local law or regulation which governs the price or allocation of refined petroleum products; however, the President may exempt certain classes or categories of laws or regulations from such preemption. IFTOA strongly endorses this provision for the following reasons.

1. Adequate Supply

The sale and distribution of petroleum and petroleum products involves interstate commerce. Oil is typically shipped through many states. For example, a refiner may send home heating oil or gasoline by pipeline or barge from its refinery in Houston to a terminal operator in New York. That marketer may in turn sell the product to marketers in New England. In brief, to ensure the most efficient distribution, oil must be "regulated" by the market or by a comprehensive, uniform regulatory program. In all but the most dire of circumstances, our Association supports the former. We are concerned, however, that individual states may have a more narrow view of the petroleum distribution system and may wish to impose controls even during periods of adequate supply. The resulting piecemeal approach could subject firms to multiple state regulations and interpretations which in turn could result in unnecessary confusion, inefficiency, and possible shortages in neighboring states. S. 1678 correctly recognizes that individual states should not be permitted to burden interstate commerce unduly and, therefore, preempts such regulation upon date of enactment.

2. Shortage

During a severe shortage, there is obviously an even greater need for the unencumbered flow of oil. Multiple state regulation under such circumstances actually could hinder the effective management of a crisis. Thus, it is essential that during an emergency the Federal program, whether it is reliance on the free market or a regulatory system, should preempt all others.

Accordingly, during times of both adequate supply and of shortage, the sale and distribution of crude oil and refined petroleum products should be dealt with on a uniform and national basis. S. 1678 provides this treatment. Moreover, the bill is careful to protect against unintended preemption of certain state and local laws by permitting the

President to exempt classes or categories of laws or regulations from its application.

B. State Set-Aside

Section 6 of S. 1678 would also authorize the establishment of state set-aside programs. If a governor were to determine that such a program is required to meet a petroleum supply shortage within the state, he would be permitted to petition the President for approval of the program. That program could require prime suppliers to set aside for emergency purposes up to 5% of the product they plan to sell for consumption within the state. The President would be required to respond to the governor's request within 10 days and, if approved, the program could remain in effect for 90 days. However, it could be extended by the President for successive 90-day periods.

IFTOA is concerned about two aspects of this proposal: (1) lack of uniformity and (2) the set-aside of up to 5%.

First, a severe petroleum disruption would not generally affect only one state; it would usually affect an entire region -- for example, New England. If each state were permitted to establish its own individual set-aside program, there could be multiple confusion and disruption of substantial portions of the market during the crisis. This problem is precisely what S. 1678 is trying to prevent. Thus, if a set-aside program is to be allowed, it must be uniform in order to be effective.

Second, a state program which permits 5% of product to be set aside, would force withdrawal of an enormous volume of product from normal distribution channels; such withdrawal would be disruptive and create higher prices and artificial shortages. Moreover, areas particularly dependent upon imported oil, such as the East Coast, could be directly and adversely affected by the activation of state set-aside programs outside of the region. For example, if the governors of Texas or Oklahoma were to implement programs in their states, they could prevent the shipment of a substantial volume of their states' excess oil from flowing to the East Coast, thereby increasing the likelihood of shortages in that region. The higher the percentage set-aside permitted by the Congress, the more serious these shortages are likely to become.

In light of these difficulties, IFTOA recommends a uniform set-aside program for residual fuel oil and refined petroleum products administered by individual states at a level below the 5%, perhaps 2-3%.

II. Strategic Petroleum Reserve

Section 5 of the bill would establish a fill-rate for the Strategic Petroleum Reserve ("SPR") of 145,000 b/d. Our Association believes that the SPR is our first line of defense during a crisis. Therefore, we have always advocated that during periods of calm, when the market is relatively soft, the United States should increase its purchases of SPR oil. While we understand the need to balance budgetary and emergency preparedness concerns, we believe it is "penny wise and pound foolish" to reduce the SPR fill-rate. Accordingly, we recommend a fill-rate of at least 220,000 b/d.

III. Voluntary Agreements and Plans of Action

Section 3 of S. 1678 would authorize the President to consult with energy industry representatives, energy consumers and other interests to encourage the development of voluntary agreements and plans of action to respond to a domestic or international energy emergency. Such plans would be approved by the Attorney General and participants in such plans would be given immunity from the antitrust laws.

We are concerned that, despite monitoring efforts by the Department of Justice and the Federal Trade Commission, such plans could lead to anticompetitive practices. These practices could have a serious adverse impact on the independent sector of the market and in the long term raise prices unnecessarily to consumers. If the Congress agrees with the Administration that our nation should rely solely on the free market during times of crises, a position which our Association does not support, then the market, not government approved plans, should determine how oil will be sold and distributed.

IV. Conclusion

The Independent Fuel Terminal Operators Association commends the Committee for developing legislation which will help to prepare the nation in case of another severe supply disruption. In particular, our Association strongly supports the preemption provision. We believe it will help to ensure that both during times of adequate supply and during a crisis crude oil and refined petroleum products will be distributed in the most economic and efficient manner.

Thank you very much.

ATTACHMENT A

MEMBERS

INDEPENDENT FUEL TERMINAL OPERATORS ASSOCIATION

Astroline Corporation
Saugus, Massachusetts

Belcher Oil Company
Miami, Florida

Bray Terminals, Inc.
Albany, New York

Colonial Oil Industries, Inc.
Savannah, Georgia

Eastern Seaboard
Petroleum Co., Inc.
Jacksonville, Florida

Global Petroleum Corp.
Dedham, Massachusetts

Meenan Oil Co., Inc.
New York, New York

Northeast Petroleum Corp.
Chelsea, Massachusetts

Northville Industries Corp.
Melville, New York

Quinoil Industries, Inc.
Quincy, Massachusetts

C.H. Sprague & Son Company
Boston, Massachusetts

Steuart Petroleum Company
Piney Point, Maryland

Swann Oil, Inc.
Bala Cynwyd, Pennsylvania

Ultramar Petroleum, Inc.
Montvale, New Jersey

Webber Tanks, Inc.
Bucksport, Maine

Wyatt, Inc.
New Haven, Connecticut

The 16 companies listed above own and control terminals capable of receiving ocean-going tankers. None is affiliated with a major integrated oil company. Members of the Association are independent marketers of No. 2 fuel oil, No. 6 fuel oil, gasoline and other petroleum products.

They distribute more than 50% of the No. 2 fuel oil consumed in New England and nearly 25% of the No. 2 fuel oil consumed along the East Coast. They distribute nearly 60% of the residual fuel oil burned by non-utility consumers in New England and nearly 50% on the East Coast.

The 16 companies own and control 56 deepwater terminals and 40 barge terminals, with a total storage capacity of more than 57 million barrels. Of the total, about 26 million barrels are for No. 2 fuel oil, about 24 million barrels are for residual fuel oil, and about 7.4 million barrels are for gasoline and other products.

ATTACHMENT

INDEPENDENT FUEL TERMINAL OPERATORS ASSOCIATION

SUITE 300
1700 PENNSYLVANIA AVENUE, N. W
WASHINGTON, D. C. 20006

PRESIDENT:
LEONARD P. STEUART, II
STEUART PETROLEUM COMPANY
WASHINGTON, D. C.

VICE PRESIDENTS:
JOHN A. KANES
NORTHEAST PETROLEUM INDUSTRIES, INC.
BOSTON, MASSACHUSETTS

WILLIAM F. KENNY, JR.
MEENAN OIL CO., INC.
NEW YORK, NEW YORK

SECRETARY-TREASURER:
ROBERT H. DEMERE
COLONIAL OIL INDUSTRIES, INC.
SAVANNAH, GEORGIA

EXECUTIVE COMMITTEE:
HAROLD P. BERNSTEIN
NORTHVILLE INDUSTRIES CORP.
MELVILLE, LONG ISLAND, NEW YORK

DUDLEY F. BLANCHARD
WYATT, INC.
NEW HAVEN, CONNECTICUT

WILLIAM L. MANNION
PITTSTON PETROLEUM INC.
NEW YORK, NEW YORK

ROBERT P. McGINLEY
THE SICO COMPANY
WILMINGTON, DELAWARE

STATEMENT

of the

INDEPENDENT FUEL TERMINAL OPERATORS ASSOCIATION

on

ENERGY EMERGENCY PREPAREDNESS

before the

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

Washington, D.C.

July 30, 1981

Mr. Chairman:

My name is John G. Buckley. I am a Vice President and Director of Northeast Petroleum Industries, Inc., of Boston, Massachuetts, an independent deepwater terminal operator which distributes petroleum products in New England. I am appearing today on behalf of the Independent Fuel Terminal Operators Association ("IFTOA") to discuss the important issue of energy emergency preparedness.

IFTOA is composed of 16 companies which operate deepwater terminals along the East Coast from Maine to Florida.*/ None is affiliated with a major oil company. Members are primarily marketers of residual fuel oils (Nos. 4, 5, and 6 fuels) and home heating oil (No. 2 fuel); several companies also market significant volumes of gasoline at the wholesale and retail levels. Members handle nearly 50% of the non-utility residual fuel oil shipped to the East Coast, nearly 60% of the non-utility residual fuel oil shipped to New England, more than 25% of the No. 2 heating oil shipped to the East Coast and nearly 50% of the No. 2 heating oil shipped to New England.

I. Senate Proposals

The Committee is considering five proposals relating to energy management during a severe supply disruption. While IFTOA believes that all have substantial merit, we will, for the convenience of the Committee, present our detailed comments and recommendations for amendment in the context of S. 1503, the "Standby Petroleum Allocation Act of 1981," which was introduced by the Chairman.

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*/ A list of members and a more detailed description of the Association is attached. (Attachment A).

A. S. 409

On February 5, Senator J. Bennett Johnston (D-LA) introduced S. 409, the "Standby Petroleum Authorities Act of 1981." The Senator's objective was to initiate debate on the subject of standby authorities; S. 409 has effectively achieved that objective, as witnessed by this hearing and the oversight hearing of May 20, 1981. The bill would establish a crude oil access program for independent refiners during emergencies but commendably does not establish a preference or bias for small refiners. More importantly, Senator Johnston underscores the need to maintain a viable independent marketing and refining sector.

B. S. 445

On February 6, Senator George Mitchell (D-ME) introduced S. 445, the "State Set-Aside Act of 1981." That bill requires the Secretary of Energy to establish a State Set-Aside Program for refined petroleum products at a level of 3 to 5 percent of supply in each individual state. IFTOA supports such a measure only if it is implemented in the context of a regulatory program.

State Set-Aside Programs have in the past been useful in dealing with small supply disruptions and individual hardship cases. However, diversion of more than 2 percent of product from normal distribution channels is likely to create distortions and artificial shortages in certain regions of any given state. Accordingly, if such a provision is approved by the Committee, a maximum limit of 2 percent of product supplied should be established.

C. S. 1354

On June 17, Senator Bill Bradley (D-NJ) and Senator Charles Percy (R-IL) introduced S. 1354, the "Emergency Preparedness Act of

1981." That bill embodies a fundamental principle which IFTOA strongly supports -- reliance on the free market. Senator Bradley believes that the best way to prepare for oil supply disruptions is by building both private and public stockpiles. Our Association strongly supports this position.

In addition, S. 1354 provides for a response to an emergency occurring before stockpiles reach adequate levels. The bill would rely on market forces to distribute scarce supplies and determine prices but would also provide increased Federal financial assistance to citizens during the disruption. If the President determines that the supply disruption is so severe that it warrants allocation of petroleum and petroleum products, he could impose such controls, but only under the authority of other existing statutes.

All of these pending bills grant the President broad authority to deal with a crisis. However, only Senator Bradley's bill clearly establishes the principle that the President should rely on the market to solve supply problems.

D. S. 1476

On July 14, Senators David Durenberger (R-MN) and Mark Andrews (R-ND) introduced S. 1476, the "Petroleum Disruption Management Act of 1981." That bill would manage petroleum disruptions through a series of staged responses -- drawdown of stocks, use of strategic petroleum reserves, limited and total allocation of crude oil, and allocation of products. While this sequential management approach has been carefully drafted, we are concerned that it is too complex and does not permit a sufficient amount of flexibility to deal with the wide variety of problems that will arise during a severe shortage.

E. S. 1503

On July 20, the Chairman introduced S. 1503, the "Standby Petroleum Allocation Act of 1981." IFTOA believes that, with a limited number of modifications, the bill will, with the changes set forth below, establish the authority necessary to manage a severe supply disruption effectively.

II. General Comments and Amendments

A. Authority

IFTOA believes that the imposition of price and allocation controls is a measure of last resort, a step that should be taken only in cases of severe and sustained shortage. Our members operate in a highly competitive market. We understand that market and know that in most circumstances distribution problems and dramatic price swings can be corrected by the normal workings of market forces. While the scarcity of energy in recent years has increased skepticism about the effectiveness of competition, it is the market, not regulation, which is the answer to our nation's energy problems.

The Emergency Petroleum Allocation Act of 1973 ("EPAA"), 15 U.S.C. §§ 751 et seq., expires on September 30, 1981. IFTOA believes that new legislative authority is needed to replace the EPAA. IFTOA also believes it is far better to adopt such legislation during periods of ample supply than during a crisis. After enactment of the legislation, standby regulations can be developed and adequate consideration can be given to the specific elements of the emergency response program. A standby program, developed and understood by all affected parties in advance, will help to minimize dislocations and disruptions during an emergency.

B. Protection For The Independent Sector

A strong independent sector is the best guarantee of competition in the petroleum market. As recent events are proving once again, competition ensures that the consumer pays the lowest possible price for products, particularly home heating oil and gasoline. In 1973, Congress recognized the important role of the independent sector; in adopting the EPAA, Congress specifically mandated that the implementing regulations (1) protect the independent sector and (2) promote and foster competition. S. 1503 should be amended to include these important objectives. We have attached proposed amendatory language which is identical to that contained in the EPAA.[*]

C. Preemption

Congress must also reaffirm that the regulation of the petroleum industry involves the regulation of interstate commerce. The sale and distribution of petroleum and petroleum products usually involve shipments through many states. For example, a refiner may ship home heating oil or gasoline by pipeline or barge from its refinery in Houston to a terminal operator in New York. That marketer may in turn sell the product to marketers in New England. In brief, during times both of adequate supply and of shortage, the sale and distribution of crude oil and refined petroleum products should be dealt with on a comprehensive, uniform and national basis.

The bills pending before this Committee and the two bills being considered in the House recognize that controls should not be implemented unless a severe supply disruption occurs. However, individual states may have a more narrow view of the petroleum distribution system, and may wish to impose controls even during periods of adequate supply. This piecemeal approach could subject firms to multiple state regulations and interpretations which could result in unnecessary confusion and inefficiency and could lead to actual shortages in neighboring states.

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[*] See Attachment B.

During a severe supply shortage, there is obviously a greater need for a uniform, national regulatory program. Multiple state regulations under such circumstances actually hinder the effective management of the crisis. Thus, it is essential that, during an emergency, the Federal program preempt all others, and the bill adopted by the Congress must provide that the Federal standby program preempts state law whether or not the program is activated. A proposed preemption amendment for inclusion in S. 1503 is attached.*/

D. Trigger

During the Arab Oil Embargo in 1973-1974 it was "estimated" that this nation experienced a 5-6% supply shortage. In 1979, after the loss of Iranian crude oil to the world market, we again suffered an "estimated" 3-4% shortfall. In both instances no one could accurately calculate the amount of crude oil and product lost, and no one could determine how long those disruptions would last. Estimates were made and remade; it was always a matter of speculation, and the Department of Energy could not provide accurate data until at least two months after the fact. In brief, past experience demonstrates that it is impossible to establish an appropriate "trigger" -- a specific event or calculation which establishes the existence of a "severe supply disruption" and activates a controls system.

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*/ See Attachment C.

Therefore, IFTOA supports the approach of S. 1503, authorizing the President to implement a standby program if he finds a severe petroleum supply shortage exists and submits that finding to Congress pursuant to the Energy Action message as provided for in Section 551 of the Energy Policy and Conservation Act, as amended.

E. Statute of Limitations

The new energy emergency statute should include a statute of limitations, preferably three years -- the period used by the Internal Revenue Service. The EPAA does not contain such a limitation; as a result, the DOE is currently in the initial stages of investigating some violations alleged to have occurred during the first six months of the regulatory program -- in 1973-74! It is simply a waste of time and resources for the government and the private sector to be concerned with transactions that occurred nearly a decade ago. A statute of limitations is an equitable and efficient means of dealing with compliance matters; it would avoid the current problem of costly, continuing, and unnecessary administrative proceedings and litigation. Attached is a proposed statute for inclusion in Section 5 of S. 1503.*/

F. Sunset Provision

In addition to authorizing imposition of controls, it is equally, if not more important to establish a standard or trigger for removing controls. The lack of a "sunset" or termination mechanism was a major failing in the 1973 law; its absence created substantial difficulties and burdens for consumers and petroleum companies, as controls were maintained far longer than necessary.[*/] In light of this experience, it is essential that any standby authority provide for the termination of controls soon after activation. Therefore, IFTOA strongly supports the sunset provision contained in Section 4(e) of S. 1503.

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*/ See Attachment D.

G. Industry Technical Advisory Board

To avoid difficulties in administering the emergency standby program, the new legislation should authorize the establishment of an Industry Technical Advisory Board. Members of the Board would represent all sectors of the petroleum industry -- producing, refining, marketing and transportation -- as well as the DOE. The industry membership would include individuals with expert knowledge and direct experience in the day-to-day operations of petroleum companies. The initial job of the Board would be to assist the President and the DOE in developing a standby program that deals intelligently with the complexities and realities of the petroleum industry. The Board could also help to assess national supply situations and, during an emergency, to evaluate the duration of a disruption. The Board could work closely with DOE, on a daily basis during such an emergency, to ensure that the regulations are administered so that product and crude oil are distributed efficiently and economically.

III. Specific Amendments Relating to Regulatory Program

A. Definition of "United States"

Section 3 of S. 1503 should be amended to include the Virgin Islands in the term "United States." As the Committee is well

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[*/] See Harvard University, John F. Kennedy School of Government, "The Use of Political Pressure as a Policy Tool During the 1979 Oil Supply Crisis," S. Erfle, J. Pound, J. Kalt, April 1980; and General Accounting Office,"Gasoline Allocation: A Chaotic Program in Need of Overhaul," (EMD-80-34), April 23, 1980.

aware, the Amerada Hess refinery located in St. Croix is the largest refinery on U.S. soil and in the world. Such a facility would play an essential role in supplying the U.S. market, especially the East Coast, during an emergency supply disruption, and must therefore be subject to the same regulations as all other domestic refiner/marketers. A proposed amendment to Section 3 is attached.[*/]

B. Allocation and Price Controls[**/]

While great flexibility should be given to the President in formulating a standby program, experience with the control program implemented in 1973 demonstrates that firm statutory direction from the Congress is necessary on a few issues.

1. Allocation Regulations

IFTOA recommends that a 12-month base period be established for determining allocation levels. This base period should be the most recent period in which "typical" transactions occurred.

2. Pricing Regulations

a. Base Period Date: Twelve-Month Reference Period For All Products

As the Committee is aware, under the EPAA pricing system, a firm's selling price on May 15, 1973 was used to establish its maximum allowable selling price. Use of that date created distortions in the market and serious hardships for many independent marketers. The Federal Energy Office ("FEO") explained that there was nothing sacred about May 15; it was simply a typical day in the petroleum industry which

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[*/] See Attachment E.

[**/] Attachment F contains amendments implementing the proposals in this subsection relating to allocation and price controls.

could provide a representative picture of margins. This was simply not true. It is not possible to look at a single date and establish a fair margin structure for all firms. By selecting one day, FEO provided some marketers with particularly high margins, others with low margins, and only some with average or typical margins. Use of a warm weather date created particularly serious distortions in the home heating oil market.

It did not reflect typical margins for marketers of middle distillates and residual fuel oil, products which are sold primarily in the winter months. The use of a shorter base period always creates problems in the case of products with cyclical demand patterns; the use of a twelve-month period avoids these problems. In short, the use of a single day did not achieve FEO's objective. It should not be used again.

The most equitable and workable base period would be twelve months. Within a twelve-month period, a marketer has high and low margins, and an average of those margins over a longer period would be far more representative. Moreover, we see no reason to distinguish between the twelve-month period used for allocation controls and that used for pricing purposes; use of identical base periods for both would provide the most accurate reflection of the market immediately prior to the emergency.

Accordingly, IFTOA recommends an indentical twelve-month base period for both allocation and price controls for all products.

b. Percentage Mark-up

DOE should not be permitted to repeat a very serious error in the 1973 regulations; the agency must be prohibited from establishing selling prices for independent marketers by adding a base period margin, calculated in "cents per gallon," to the base period selling price. The use of a fixed, "cents per gallon" mark-up slowly, over the period of regulation, eroded the economic viability of the independent segment of the industry.[*/] In an inflationary economy the adequacy of a fixed mark-up is continually reduced; as costs increase, the marketer finds its per-gallon return diminishing significantly.

Prior to EPAA regulations, the petroleum industry had historically used a percentage mark-up in establishing selling prices. Accordingly, we recommend that any new standby program employ this historical method as its pricing mechanism. Each marketer should be permitted to add its average percentage-of-cost margin to its most current acquisition costs, determined over a 12-month period.[**/] Such a formula would prevent excessive profits during a period of shortage but would also ensure the historical profitability and viability of the independent sector.

c. Normal Business Practices: Credit Practices and Summer Fill Programs

Under the former DOE program, suppliers were required to maintain normal practices in dealing with their purchasers during the supply crisis. This regulation required the continuation of credit practices and policies in effect during the base period. For example, if, during the base period, a marketer had the option of paying its bill within 10

[*/] See generally White Paper on "Competitive Viability of the Independent Fuel Oil Marketer," Fuel Oil Marketing Advisory Committee, Department of Energy (December 5, 1977).

[**/] As indicated, the period for measuring margins would be identical to the period used for determining allocations and base period prices.

days of its receipt and receiving a 1% discount, its supplier could not modify those terms during the regulated period.

In addition, the regulations mandated the continuation of "summer fill" programs. Pursuant to those programs, terminal operators purchased heating oil in the summer and deferred payment until October. The program insured that product moved through the distribution chain, storage was filled to meet winter demand, and cash flow problems of independent marketers were relieved. IFTOA strongly recommends that the Congress require maintenance of historical credit practices and summer fill programs under any future standby program.

3. *Retroactive Rulings*

Because of serious ambiguities and contradictions in the Federal Energy Office and Federal Energy Administration regulations, the agency has continually attempted to clarify and amend those rules. While such clarification was badly needed, the agency has been accusing marketers of "violating" the regulations because they had not anticipated and thus had not followed interpretations issued several years *after* the regulations were promulgated. Such inequitable treatment has been repeatedly challenged in Federal Court; the courts have struck down many regulations as being retroactively and illegally implemented.*/ Accordingly, in 1978 Congress amended the Department of Energy Organization Act and added a specific prohibition against retroactive application of DOE

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*/ *See Standard Oil Co. v. FEA*, 440 F. Supp. 328 (N.D. Ohio 1977) and *Phillips Petroleum Co. v. FEA*, 435 F. Supp. 1239 (D. Del. 1977), *aff'd*, 596 F.2d 1029 (TECA 1978). *See also Tobin v. Edward S. Wagner Co.*, 187 F.2d 977 (2nd Cir. 1951); *Sampson v. Clark*, 162 F.2d 730 (Em. Ct. App. 1947).

regulations.[*/] Despite this clear expression of Congressional intent, DOE has been able to circumvent the provision.[**/] Therefore, we strongly recommend that this Committee restate and clarify, in its report to the Senate, that no civil action or order may be brought under the new Act, based on a retroactive application or interpretation of a rule or regulation.

4. Inventory Appreciation

There is a general consensus that the building of both public and private product and crude oil reserves is an essential element of our national energy policy. In fact, several reports have found that ample energy oil stockpiles are the single most reliable and cost effective means of deterring oil import disruptions and reducing their impact.[***/] In a free market, the opportunity to receive inventory

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[*/] 42 U.S.C. § 7193(g). This section was originally Section 7(k) of the FEAA, P.L. 93-275, 15 U.S.C. § 776(k). Section 709 of the Departent of Energy Organization Act, P.L. 95-91, deleted this provision from the FEAA, but Section 805(a) of the Power Plant and Industrial Fuel Use Act of 1978, P.L. 95-620, restored the provision as Section 503(g) of the DOE Act.

[**/] See e.g., Cooper and Brain, Inc. Case No. DEE-1405, proposed Decision and Order, aff'd, 4 DOE ¶81,110 (August 30, 1979).

[***/] Staff Report of the Senate Committee on Energy and Natural Resources, "The Geopolitics of Oil," (November 1980). "Reducing U.S. Oil Vulnerability: Energy Policy For the 1980's," An Analytical Report to the Secretary of Energy, prepared by Assistant Secretary for Policy and Evaluation, U.S. Department of Energy (November 10, 1980). Levy, "Oil and The Decline of The West," 58 Foreign Affairs 999, 1007-8, 1015 (1980). Nye, "Energy Nightmares," Foreign Policy, Fall 1980, 132, 132-4, 139-40, 142-3, 149-50. Stobaugh and Yergin, "Energy: An Emergency Telescoped," 58 Foreign Affairs 563, 593 (1980).

appreciation provides sufficient incentive to build private petroleum stocks. For example, a refiner or marketer may buy heating oil product in the spring and summer months, store it, and sell it in the fall and winter. In a rising market, the value of the product continues to rise and the marketer will be able to sell the product at an increased price which justifies his investment. However, there is no incentive to accumulate and maintain stocks if the industry believes that price controls will be imposed on oil placed in storage and that inventory appreciation will not be recoverable. Therefore, IFTOA recommends that, in order to ensure the maintenance of private stocks to meet an emergency, the standby program contain a specific provision which exempts product in inventory from price controls.

IV. Conclusion

The Independent Fuel Terminal Operators Association strongly recommends that the Committee enact legislation which will authorize the establishment of a standby program which can be implemented during a severe supply disruption. Such legislation will ensure that the United States will be able to deal effectively with an energy emergency after September 30, 1981, the date of expiration of the EPAA.

Thank you very much.

ATTACHMENT A

MEMBERS

INDEPENDENT FUEL TERMINAL OPERATORS ASSOCIATION

Belcher Oil Company
Miami, Florida

Bray Terminals, Inc.
Albany, New York

Colonial Oil Industries, Inc.
Savannah, Georgia

Eastern Seaboard Petroleum Co., Inc.
Jacksonville, Florida

Gibbs Oil Company
Revere, Massachusetts

Meenan Oil Co., Inc.
New York, New York

Northeast Petroleum Industries, Inc.
Chelsea, Massachusetts

Northville Industries Corp.
Melville, New York

Pittston Petroleum, Inc.
Montvale, New Jersey

Quinoil Industries, Inc.
Quincy, Massachusetts

The Sico Company
Wilmington, Delaware

Swann Oil, Inc.
Bala Cynwyd, Pennsylvania

C.H. Sprague & Son Company
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Steuart Petroleum, Inc.
Piney Point, Maryland

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New Haven, Connecticut

The 16 companies listed above own and control terminals capable of receiving ocean-going tankers. None is affiliated with a major integrated oil company. Members of the Association are independent marketers of No. 2 fuel oil, No. 6 fuel oil, gasoline and other petroleum products.

They distribute nearly 50% of the No. 2 fuel oil consumed in New England and nearly 30% of the No. 2 fuel oil consumed along the East Coast. They distribute nearly 60% of the residual fuel oil burned by non-utility consumers in New England and nearly 50% in the Middle Atlantic states.

The 16 companies own and control 61 deepwater terminals and 39 barge terminals, with a total storage capacity of nearly 75 million barrels. Of the total, nearly 30 million barrels is for No. 2 fuel oil and nearly 40 million barrels is for residual fuel oil.

ATTACHMENT B

AMENDMENT TO S. 1503

Preserve Competition (Section 4)

On Page 4, after line 11, insert the following new subsection:

> "(3) preserve an economically sound and competitive petroleum industry; including the priority needs to restore and foster competition in the production, refining, distribution, marketing, and petrochemical sectors of such industry, and to preserve the competitive viability of independent refiners, small refiners, nonbranded independent marketers, and branded independent marketers."

ATTACHMENT C

AMENDMENT TO S. 1503

Federal Preemption (Section 4)

On page 5, after line 25, insert the following new subsection:

> "(g) This Act shall preempt any provisions of any programs established by any state or local government which subject crude oil or refined petroleum products to allocation or price regulation. This preemption shall be effective regardless of whether the standby regulation authorized by this Act is implemented by the President."

ATTACHMENT D

AMENDMENT TO S. 1503

Statute of Limitations (Section 5)

On page 6, after line 18, insert the following new subsection:

> "(d) Except as otherwise provided in this Act, a proceeding to enforce regulations developed and implemented under Section 4 may be brought only within three years of the date on which the transaction in question occurred."

ATTACHMENT E

AMENDMENT TO S. 1503

Adding Virgin Islands (Section 3)

On page 3, line 21, after the comma, insert the following:

"the Virgin Islands,".

ATTACHMENT F

AMENDMENTS TO S. 1503

1. Allocation Regulations (Section 4)

On page 4, line 4 after "United States.", insert the following new sentence:

> "such allocation shall utilize a 12-month base period which reflects the most representative recent market conditions."

2. Percentage Mark-up (Section 4)

On page 4, delete lines 19 and 20 and insert in lieu thereof:

> "(2) such controls are limited to non-discriminatory pricing and to average percentage-of-cost margins added to most recent acquisition costs."

3. Normal Business Practices (Section 4)

On page 4, after line 20, insert the following new subsection:

> "(3) such controls shall require the maintenance of normal business practices, including 'summer fill' programs, in effect during the base period."

On page 4, line 18, delete "and."

On page 4, line 20, delete the "." and insert ", and"

4. Inventory Appreciation (Section 4)

On page 5, line 2, delete the "." and add the following:

> ", provided, that such allocation shall not be applicable to crude oil, residual fuel oil or any refined petroleum product in inventory on the date of implementation."

SENATE OF THE UNITED STATES

COMMITTEE ON ENERGY AND NATURAL RESOURCES

Hearings on S.1678

Statement of Gregg Potvin

Mr.Chairman & members of the Committee,this statement is presented on behalf of the National Association of Texaco Wholesalers, the Illinois Petroleum Marketers Association and the Texas Oil Marketers Association. Thank you for this opportunity to present their views.

Recent world headlines have once again made clear the potential transitory nature of our current adequacy of supply of crude oil. The consideration of legislation insuring that an energy emergency could be met with appropriate measures is commendable.The statement of proposed findings and purposes contained in the bill is , on the whole,salutory.

However when one reads the contents of the bill beyond that point it rapidly becomes apparent that though the voice may be that of the Federal Government- the hands are those of big oil.

It is undeniably true that the entire petroleum industry, including independent small business marketers, would be reluctant to return to the bureaucratic rigor and complexity of full scale price and allocation controls. However, to expose these small businessment to the unbridled tender mercies of their refiner-suppliers, who are also to a rapidly increasing degree their competitors as well, is clearly unconscionable.

Yet this appears to be precisely what S.1678 would do.

Consider what the bill provides.

A program devised and implemented by big oil- with total exemption from the antitrust laws and all conflict of interest statutes. The same group of multi-billion, multi-national giants that in the recent past amassed the largest aggregate of overcharges in civilized history. The same group that, in the even more recent past , has had a number of spokesmen announce that the policy of their firm is to decrease the market share of their independent wholesalers. Is it any wonder that this measure is arousing fear and apprehension in the hearts of so many small business marketers?

But- a defender of the bill might be heard to correctly say- S.1678 takes this into account. After all, it requires that any plan utilized in response to an energy emergency be approved by the Department of Energy, the Department of Justice and the Federal Trade Commission. It even requires a report concerning its impact upon small business.

The intent in providing these safeguards is commendable. The assurance supplied is negligible- or less.

The Secretary of Energy, the Attorney General, the Assistant Attorney General for Antitrust and the Chairman of the Federal Trade Commission are all fine gentlemen.They are worthy of the respect of their fellow citizens for, I am sure, a myriad of reasons. But the fact of the matter is that their combined attention to the preservation of competition and the survival of the small business sector of the petroleum industry offers no comfort.

In recent months the Department of Energy has sent its minions before state legislative bodies to testify against legislation sought and sorely needed by very same small businessmen this bill would have them protect. The Department of Justice espouses vertical price maintenance and , according to the press , declines to enforce existing law on that subject. The Federal Trade Commission has resolutely refused to investigate predatory pricing by Arco in situations where even the most biased observer would be hard put to deny its blatant presence.

Mr.Chairman, it is self evident that the apparent safeguards contained in the bill simply are not adequate when measured in terms of the views expressed and actions taken by the agencies involved. You and your distinguished colleagues understand, I know, the considerable transitions that are taking place in the petroleum marketplace. A growing number of small businesses face economic extinction. All of them are seriously concerned regarding their future.

There are additional problems with the bill. It would place decisional and implementive authority regarding public questions within the private sector. In the event of an energy emergency states at the end of supply lines - such as Idaho- could be severely injured. Should the president of Exxon opt for supplying more densely populated areas nearer its refining facilities and thereby more profitable to his shareholders or choose - in pursuit of the public interest- to supply more distant border states? Should Mobil really be the one to choose whether the widow in Massachusetts goes cold or the farmer in Arkansas cannot harvest his crops? Even the Mobil corporate office of flackery so noted for its volume-if not its vision-might have trouble coping with this sort of enforced trade-off .

The preemption feature of Section 6 of the bill is also alarming. To Federally preempt is one thing- to subrogate the power of an individual state to this sort of corporate planning is quite another.

It is our hope Mr.Chairman that the Committee will retain its concern and interest regarding the necessity to cope with an energy emergency but will find a more realistic and appropriate manner than the extreme and bizarre method set forth in S.1678.

Official Committee File

SERVICE STATION DEALERS OF AMERICA

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VIC RASHEED
Executive Director

October 27, 1983

SENATE COMMITTEE ON
ENERGY AND NATURAL RESOURCES
RECEIVED
OCT 28 1983
WASHINGTON, D.C. 20510

Honorable James P. McClure
Chairman, Committee on Energy and
  Natural Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman,

The Service Station Dealers of America is vitally concerned with the provisions of S. 1678, which proposes amendments under the Energy Policy and Conservation Act to deal with future energy emergencies.

We would like to take this opportunity to further express our anxieties on behalf of over 60,000 service station dealers, most of whom where deeply involved in implementing the provisions of past emergency programs.

We are seriously alarmed by some of the proposals in S.1678 which we believe will destroy public confidence in the administration of future energy emergencies.

The administration of this program must be completely beyond reproach, based on the experience of past energy crises.

To maintain its unquestionable integrity and impartiality, administration of the program cannot be placed in the hands of officers of major oil companies, many of whom are still involved in federal cases involving pricing overcharges, amounting to billions of dollars from previous fuel shortages.

Oil company policies involving price exploitation of the consumer, were directed by some of these same oil company officials who could now possibly be nominated to direct our energy program in the next emergency.

They would then be expected to set aside their normal goals of furthering the profits of their companies and become unbiased public servants. Their past record shows this to be virtually impossible.

OFFICERS

DON S[illegible]	TRACY STANTON	DAVE WOODWARD	EMMETT PROBUS	TOM MAH[illegible]	JERRY COHEN, Esq
President	First Vice President	Second Vice President	Third Vice President	Treasurer	General Counsel
Mill Valley, CA	Bexley, OH	Ft. Lauderdale, FL	Louisville, KY	Mountainside, NJ	Washington, DC

In addition, they will operate with the knowledge that they will be given immunity against any civil or criminal action brought against them under the anti trust laws, as a result of any actions which they may take, (provided that such actions were not taken for the purpose of injuring competition). This latter proviso however may be very difficult to prove as to intent.

The assurance that the Attorney General and the Federal Trade Commission shall each submit to the Congress and to the President, an annual report on the impact on competition and on small business, does little to ease our concern over the proposed administration of this vital program.

Our second major concern involves Sec. 6. and its effect on State laws.

This will allow the total preemption of all state laws applying to pricing or allocation of any petroleum product. This is a direct contradiction of previous administration policy.

We believe this to be a serious error since the states in previous emergencies, were able to play a very important part in the administration of energy policy, allocation, enforcement etc., because of their close contact with wholesale and retail distributors and consumers.

To take away their flexibility to cope with local situations and to bring them now under one huge federal bureaucracy, could cause a serious bottleneck in the proper administration of any future shortage.

While we certainly believe that there must be provisions in the Act to guarantee emergency, energy, preparedness, we believe that the development of proper stand-by emergency controls would ensure efficient equitable administration of any new energy crisis, without any surprises. We need a program that will set out an equitable allocation policy with adequate price-control safeguards. Our association is on record as favoring such a program.

We would be glad to work with you and your commitee on such a program.

Sincerely Yours,

Vic Rasheed

Vic Rasheed
Executive Director

VR:kl

SOUTHEASTERN ELECTRIC RELIABILITY COUNCIL

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September 21, 1983

The Honorable James A. McClure, Chairman
Senate Committee on Energy and Natural Resources
3121 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator McClure:

BILL S. 1678

Senate Bill S. 1678, "Energy Emergency Preparedness Act Amendments of 1983," introduced by you and Senator John W. Warner, has been reviewed by SERC's Executive Committee, and we are deeply concerned by the damage it would do to electric power system reliability if it should be passed. It would eliminate a time-tested and war-tested organization, formerly called Defense Electric Power Administration.

Placing the management of emergency operation of utilities under full-time, salaried Federal employees would be certain to damage electric reliability by reducing the role of knowledgeable utility people to that of "advisors."

While an organization such as DEPA is needed for a state of war or mobilization preceeding war, utilities continue capable of managing other emergencies, and the imposition of a large Federal bureaucracy with complete responsibility for decisions would also be strongly damaging to electric reliability in peacetime.

Utilities continue to feel that it is dangerous to put together details for a "plan for sabotage" because such plans, published as required in this Bill, could place them in the hands of enemies.

SERC's detailed position on Bill S. 1678 is covered in the attached memorandum. We believe that the passage of this Bill would be bad for electric utilities and that it should be withdrawn. If you feel that legislation is needed in connection with the Strategic Petroleum Reserve, then we urge that all references to electric utilities be stricken from the Bill.

Sincerely,

E. A. Adomat

E. A. Adomat
Chairman

EAA/llh

Attachment

cc w/attachment:
The Honorable John W. Warner
The Honorable Donald Paul Hodel
SERC Executive Committee
Mr. Richard O. Newman, Chairman, NERC

SOUTHEASTERN ELECTRIC RELIABILITY COUNCIL

BILL S. 1678

The Executive Committee of the Southeastern Electric Reliability Council (SERC) has reviewed Senate Bill 1678, "Energy Emergency Preparedness Act Amendments of 1983," introduced by Senator James A. McClure and Senator John W. Warner, and is alarmed by the damage it would do to electric power system reliability if it should be passed. It would deal a death blow to a well conceived and thoroughly tested organization of utility people formerly known as the Defense Electric Power Administration.

SERC is a voluntary organization of 27 electric utilities covering all or parts of ten Southeastern states. It includes investor-owned, Federally-owned, municipal and state utilities, and rural electric cooperatives. It is one of nine Regional Councils comprising the North American Electric Reliability Council (NERC) which covers the continental United States and most of the electric generating capacity in Canada.

DEPA was established on December 4, 1950, with the U.S. Department of Interior, with the following principal functions:

1. Allocation of controlled materials for defense electric power construction projects;
2. Surveying the nation's electric power needs to meet defense loads and emergencies; and
3. Reviewing applications by electric utilities for certificates of rapid tax amortization.

These functions were handled successfully during the Korean War. The Department of Interior had delegated to it in 1955 specific responsibilities in the electric power field by the Office of Defense Mobilization and Federal Civil Defense Administration. In 1966 DEPA was expanded with an improved field structure and an Industry Advisory Committee, the latter consisting of chief executive officers of large electric utilities. In the Statement of Policy, this Committee noted that "electric utilities, because of their obligation to provide reliable electric service to the public, are well equipped to cope with most emergencies. However, the rendering of essential electric service to the fullest extent possible during and after a nuclear attack involves planning and preparation measures beyond that required to meet peacetime emergencies." The field structures included an Area Director and a Deputy Area Director for each of nine Regions in the U.S. There were also Sub-Area Directors and Power Liaison Representatives. Those selected for this service were usually officer or manager level people currently employed by electric utilities or by operating pools or councils. In time of war or national emergency, these selected people would become Federal employees, without compensation (supported by their original organization), with full authority to manage critical materials for utilities and to coordinate their efforts to supply necessary defense and civilian loads. Arrangements for keeping up to date were made, including training meetings and training exercises which lasted until 1977.

Under the Department of Energy, this organization was neglected and denigrated. No meetings were held, the Industry Advisory Committee was abolished, various elaborate schemes of organization were proposed, and finally in early 1983 a Steering Committee was formed, consisting primarily of former Area Directors. At meetings with the Department of Energy, this Steering Committee urged:

1. Ordinary emergencies should continue to be handled by the electric utilities involved, with whatever help they might request from the Federal Bureau of Investigation, etc.; and
2. An organization similar to DEPA should be formed, utilizing utility people who would make decisions in time of war or national emergency.

In stark contrast to the previous operations of DEPA, the Bill (beginning on Page 5, Section 3) would leave all decisions to "full-time, salaried employees of the Federal Government." Activities of utility people would be limited to giving advice to DOE. They would not even be allowed to talk with one another without having a full transcript of the conversation delivered to the Department of Energy, the Attorney General, and the Federal Trade Commission. Again, on Page 7, Item 3, it is stated, "appointees under this subsection shall, when policy matters are involved, be limited to advising appropriate full-time, salaried Federal Government Officials who are responsible for making policy decisions." The Executive Committee of SERC believes firmly that an organization which gives authority to utility people has been shown through years of experience to be far more effective than any group of "full-time Federal Employees," and that the creation of this huge bureaucracy of such employees is not only unnecessary, but extremely damaging to the reliability of electric power supply during national emergencies. We have been led to expect less regulation, not a vast increase in a regulatory bureaucracy.

In peacetime, the passage of this Bill would seriously impair the reliability of bulk electric power supply. As noted by the former Industry Advisory Committee, "electric utilities, because of their obligation to provide reliable electric service to the public, are well equipped to cope with most emergencies." This is true regardless of whether the disturbance is initiated by weather or by the Weathermen. People operating electric utilities are intimately familiar with the status of all facilities and equipment, the availability of emergency power from interconnections, access to law enforcement agencies where criminality is suspected, the best sequences for restoring interrupted service, the availability of spare equipment such as transformers from other utilities, etc. Yet this

Bill groups ordinary peacetime emergencies with a state of war, with utility people limited to advising appropriate full-time, salaried Federal Government Officials who are responsible for making policy decisions.

On Page 12, "Voluntary agreements and plans of action for energy emergencies," there is substantial provision for the making of voluntary agreements. If these are intended to apply to electric power systems, then a serious hazzard is involved. Agreements on what would be done in certain described emergencies would necessarily pinpoint areas where certain sabotage would be especially destructive. Through the years utilities have resisted anyone putting together a "plan for sabotage" and having this information even written down, much less published. With the full-fledged publication required by the Bill, all of these plans would be in the hands of potential enemies.

Even if it is not intended that these "voluntary agreements" apply to electric utilities, the placing of decisions in the hands of "full-time Federal employees" is bound to harm, not help, a utility. In case of a substantial emergency in one area, would full-time Federal employees decide whether service, even if available, should be delayed to a factory in one area until such time as power could be supplied simultaneously to a competitor? Decisions on how best to restore service are needed immediately, and are best made by experts on the scene. Even the present requirements of reporting interruptions to the Department of Energy tend to take the time of key men who should be devoting all their energies to restoration. Would a "noticed" meeting be called to determine what orders to give a utility to resynchronize an electric island? Meetings, presumably to reach decisions, must be open to "consumers and the public."

In the case of a power shortage which involves the shutdown of one or more nuclear units, the utilities should deal directly with the Nuclear Regulatory Commission. It has been found in this area that when the Department of Energy seeks to interpose itself between the utility, the Council, and the Nuclear Regulatory Commission, the understanding by that latter agency is less clear, and a less appropriate result is achieved. The proposed huge Federal bureaucracy could do nothing but delay, inhibit, confuse, and worsen the effects of any peacetime emergencies.

To the extent that a number of systems in SERC, mostly in Florida and the Virginia-Carolinas Subregion, make substantial use of residual oil for boiler fuel, and since most coal-fired units require certain amounts of No. 2 oil for startup and flame stabilization, we have a substantial interest in the oil portions of this Bill. It would reduce the mandated fill rate of the strategic petroleum reserve from 220,000 barrels per day to 145,000 barrels per day, and would delay funding for the construction of the Big Hill Storage Facilities until fiscal year 1985. For this reduction and delay, there is a claim to saving the taxpayers about $1 billion. We have seen no information that justifies this cutback in fill rate from a national security standpoint, and it should be obvious that real savings for the taxpayer could be achieved by accelerating the fill rate during times of oil glut rather than diminishing that rate.

Certain sections of the Bill provide for relieving "without compensation" people from antitrust accusations. DEPA Area Directors through 1976 did not need such protection, financial disclosures, etc., and only after passage of legislation creating the Department of Energy did this become a problem. It should be cured at the source by amending that legislation.

SUMMARY

Senate Bill 1678 is an extremely bad Bill from the standpoint of electric utilities in the United States. It finishes the destruction of a time-tested method of managing strategic materials for electric utilities and the coordination of their power supply. It would produce instead a huge Federal bureaucracy where people with no current utility experience would make all of the decisions.

The cutback in the fill of our strategic oil reserves also is in the wrong direction, especially under oil glut circumstances, and accordingly, there is no justification for the Bill.

If anyone feels that legislation dealing with oil reserves is needed, then we urge that all reference to electric utilities be stricken from the Bill.

Protection against antitrust involvement belongs in an amendment to the legislation creating the Department of Energy, which created the problem.

SERC-EAA-WRB/11h
September 21, 1983

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October 31, 1983

SENATE COMMITTEE ON
ENERGY AND NATURAL RESOURCES
RECEIVED
NOV 1 1983
WASHINGTON, D.C. 20510

Official Committee File

The Honorable James A. McClure
Chairman
Committee on Energy and Natural
Resources
United States Senate
360 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Our client, the Society of Independent Gasoline Marketers of America ("SIGMA"), has requested that we contact you to express the Association's misgivings regarding the provisions of S.1678, the Energy Emergency Preparedness Act Amendments of 1983 ("the Bill"). Specifically, SIGMA fears that enactment of the Bill, as currently drafted, could result in irrevocable injury to the independent segment of the petroleum products market and a substantial, anticompetitive alteration of the competitive structure of that marketplace.

SIGMA is a trade association comprised of approximately 240 independent marketers and private brand chain retailers of motor fuels. SIGMA's members market motor fuels in 49 of the 50 states and their sales account for between 10 and 15 percent of the retail motor fuels market. SIGMA's members are among the most efficient retailers of motor fuels in the country. Their businesses have been built upon innovation and functional efficiencies which minimize the amount of cost which must be recovered in the per unit sales price of the motor fuels they distribute. Thus, SIGMA's members historically have been recognized as an essential component of price competition in the motor fuels market.

As Congress previously has recognized, because independent marketers do not possess the means to produce or refine crude oil, they are most vulnerable to economic injury during periods of supply disruption. It is a simple economic reality that if such businesses are deprived of access to competitively-priced supply for even relatively short periods of time, they may be eliminated from the marketplace permanently. Thus, it is essential that the government make adequate provision to ensure that in the event of a supply disruption, the market power accruing to those entities possessed of supply not be employed in a manner which effectively denies the independent marketing system access to competitively-priced product.

SIGMA's concerns with respect to the Bill focus primarily on the immunities which would be created under subsections (f) and (i) in the proposed new section 274 for which section 3 of the Bill provides. Specifically, SIGMA believes that the granting of a defense to actions brought under the antitrust laws or for breach of contract, based on the assertion that such actions were taken to deal with a domestic or international energy emergency, would effectively eliminate the only protection afforded the competitive structure of the petroleum products market in the context of a severe petroleum supply disruption. Given the long-term economic consequences which would be generated by a substantial alteration in the competitive structure of that market, SIGMA is concerned that the ultimate cost to the economy of providing such defenses could outweigh the short-term benefits to the economy which these grants of immunity could provide.

SIGMA is sympathetic with the objectives of the Bill, i.e., the development of a contingency plan, which would involve a minimum of government interference in the marketplace, for the country to employ in response to a severe petroleum supply disruption. However, SIGMA does not perceive the granting of effectively unfettered flexibility to the most economically powerful participants in a marketplace as the only means of attaining this objective, much less the desirable means of attaining this objective.

It is an underlying purpose of the antitrust laws to protect the consumer's interest in obtaining goods and services through a highly competitive market mechanism by prohibiting the abuse of disproportionate market power. It is precisely in the context of a supply disruption that the greatest opportunity for such an abuse of market power is created. Therefore it is precisely in the context of a supply disruption that the need for the protection afforded by the antitrust laws is at its greatest.

The companies to which the benefits of the defenses to antitrust actions most likely would be granted are those already possessed of the greatest market power as a result of their extensive control of the sources of raw materials and means of manufacture for refined petroleum products. Permitting these disproportionately powerful companies effectively to administer a supply disruption would offer the potential for market apportionment and the destruction of the segment of the marketing industry which historically has been recognized as the most price-competitive segment of that market. It simply is not enough to have officials from the Department of Justice and the Federal Trade Commission monitor the creation and authorization of the envisioned voluntary plans. The Nation's experience in price and allocation controls demonstrated that the Federal Government's understanding of the structure of the industry and the implications for all segments of the industry of any particular proposed course of action is grossly inadequate. Thus, those individuals charged by the Bill to ensure that voluntary plans of action have a minimal negative effect on competition will be inadequately informed to make that determination. As a result, actions which were authorized with every good intention may in fact generate consequences which were unforeseen and devastating to the long-term interests of the consumer.

The Bill's proposal of a defense to breach of contract actions is of similar concern to SIGMA. If one of the Bill's objectives is to encourage responsible action by private participants in the marketplace to protect themselves, and their customers, against the consequences of a supply disruption, then this proposed provision would clearly conflict with the achievement of that objective. It must be remembered that an independent marketer does not possess the means of producing petroleum products. Thus, such an entity's only ability to secure its miniminal supply needs is through private contract. If such contracts could be abrogated as a part of suppliers' participation in the voluntary plan, then a principal rationale for marketers' entering into long-term supply contracts would be eliminated. As a result, marketers, as a class, will be deterred from acting in the only way available to them to provide against the contingencies of potential supply disruptions.

It is also noteworthy that the provision of a defense in breach of contract actions would effectively vitiate the provisions of the Petroleum Marketing Practices Act of 1978. That Act: (1) recognizes the unequal bargaining power of suppliers and their customers, and (2) attempts to ensure that a supplier's disproportionate market power is not abused to the detriment of its independent customers and consumers who have grown to rely on those entities.

In summary, if enacted as proposed, S.1678 would create an unacceptable risk for the imposition of an unnecessary and irrevocable injury on the competitive structure of the refined petroleum products marketplace. Such an injury could result in the effective restructuing of that market and the elimination of entities whose functional efficiencies have historically benefited consumers. The elimination of such efficient participants in the petroleum products market would result, over the long-term, in economic dislocations of a magnitude at least as great if not greater than those against which the Bill attempts to protect the economy. Thus, SIGMA respectfully requests that you and other members of the Committee reassess the desirability of the Bill's provisions. It is SIGMA's hope that in this process of reassessment other alternatives, which bear significantly less risk of imposing substantial injury on the structure of competition, may be developed and brought forward for consideration.

On behalf of SIGMA, I wish to thank you for your consideration in this matter. The Association would be happy to respond to any questions which this letter may have raised and to assist you and your staff in any way which you consider desirable in the development of an effective plan of national response to a petroleum supply disruption.

Sincerely,

R. TIMOTHY COLUMBUS

Counsel to Society of
Independent Gasoline
Marketers of America

RTC:caw

APPENDIX V

Answers to Strategic Petroleum Reserve and Emergency Preparedness Questions Submitted to Department of Energy in Connection With May 6, 1983, Hearing Before the Appropriations Subcommittee on Interior and Related Agencies

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ADDITIONAL COMMITTEE QUESTIONS

Days of Net Oil Imports

Question: For fiscal year 1984, you have requested 583 million, 100 thousand dollars for oil acquisition and transportation. At your calculated cost of $35.08 per barrel during 1984, this funding will allow the purchase of some 16 million barrels of petroleum, all of which is planned for delivery in 1985. Based on fiscal year 1983 purchases which will be delivered during 1984, the total fill at the close of fiscal year 1984 is projected to be 410 million barrels, or 54.6 percent of the total planned SPR completion level of 750 million barrels. Based on the projected fill of 410 MMB and on the current level of net oil imports, how many days of inventory does this level represent if all imports were stopped? How many days of inventory does it represent if imports from OPEC sources were stopped?

Answer: Due to minor revisions in FY 1983 SPR fill rate projections, a 411 million-barrel inventory would be achieved by the end of FY 1984 if a 145,000 barrels per day rate is sustained in FY 1984.

During calendar year 1982, U.S. net oil imports excluding oil for the SPR, averaged 4.037 million barrels per day; a 411 million-barrel inventory would thus represent approximately 102 days of equivalent 1982 oil imports. During 1982, the United States imported an average of 2.113 million barrels per day from OPEC nations; a 411 million-barrel inventory would thus represent approximately 195 days of equivalent 1982 U.S. imports from OPEC.

SPR Fill Policy

Question: Is it good policy to gamble on lower fill levels when you are faced with the realities of world politics and the countries from which we are purchasing so much of our SPR oil?

Answer: Overall budget considerations have compelled the Administration to propose reductions in a variety of programs, including but not limited to the SPR. Although outlays for SPR petroleum purchases are off-budget; they affect Federal borrowing and economic activity the same as on-budget spending. The budget request for FY 1984 also takes into account the dramatically improved oil market, the reduction in U.S. reliance on imported oil and the improved U.S. capability to deal effectively with disruptions through the buildup of the SPR to over 300 million barrels. The SPR budget request continues at a reasonable rate the growing capability of the SPR to provide economic and strategic security to the nation.

Question: If the Congress determines that your 1984 request is insufficient and determines that a minimum 220,000 average barrel per day level is more desirable, how much oil over that already planned for 1984 delivery will you have to purchase?

Answer: Under current Administration oil price projections, if the SPR is filled at a rate of 220,000 barrels per day during FY 1983, available budget resources would permit the acquisition of 69.2 million barrels (190,000 barrels per day) for delivery during FY 1984. In addition, the President's FY 1984 request would provide for 18.8 million barrels to be purchased in FY 1984 for delivery in FY 1985.

A further 11.1 million barrels would need to be acquired for delivery in FY 1984 to achieve a 220,000 barrels-per-day rate in that year.

Question: What will the total 1984 acquisition cost be to meet the 220,000 barrel per day level?

Answer: The total acquisition cost for 220,000 barrels per day in FY 1984 would be approximately $2,426 million under current oil price projections plus a further $40 million for interim storage. The extent to which this would require additional budget resources is dependent on decisions regarding FY 1983 fill rates and the level of advance orders for FY 1985.

SPR Price Per Barrel

Question: The weighted average price per barrel of crude oil delivered to SPR terminals during the period of October 1, 1982, through December 31, 1982, was $34.16 per barrel. What was the weighted average per barrel price for such crude delivered between January 1, 1983, and March 31, 1983? How do these figures compare with the average market contract price and spot market price during the same six month period?

Answer: The weighted average per barrel price for crude oil delivered between January 1, 1983, and March 31, 1983, is estimated to be $31.30, excluding customs duties, terminalling charges, environmental taxes, and contract discounts.

It is difficult to derive meaningful comparisons between SPR cost experience and that of the private sector because of the many factors including crude quality, location, and contract terms, which are important in establishing the market value of crude oil. Also, average U.S. refiner cost information for the first three months of 1983 is not yet available. However, the February 1983 Short-Term Energy Outlook published by the Energy Information Administration suggests that the average refiner acquisition cost for imported oil in the fourth quarter of 1982 was $33.07 per barrel.

For the first quarter of 1983, this report established a range of price forecasts from $30.67 per barrel to $33.08 per barrel. In general, SPR oil price experience is very similar to private sector experience, with higher-sulphur (sour) crude supplies costing somewhat below the private sector average for all quality crudes, and lower-sulphur (sweet) crude supplies costing somewhat above the commercial average. In addition to crude oil quality factors, SPR cost experience is affected by the requirements of the Cargo Preference Act concerning use of U.S. flag transportation.

Storage Facilities Development

Question: As I mentioned earlier, the House of Representatives on March 10, 1983, disapproved a proposed deferral of $57.4 million of fiscal year 1983 funds. This deferral was intended to slow development of the Phase III, 140 million barrel Big Hill storage site. As of March 31, 1983, DOE had not spent any of these funds but, rather, was studying options for their use. Have you completed that study? If so, what are your recommendations if other than continued development of Big Hill? If not, when do you expect to complete the study? How long do you believe you can hold these funds before you will be in violation of the Impoundment Control Act?

Answer: While a short amount of planning time was necessary to decide how best to proceed, Big Hill development is now occuring at an accelarated pace. Over $21 million has been obligated and an additional $71 million is committed but not finally obligated. Details of Big Hill funding that has been obligated and committed from FY 1981 to date are presented below:

	Procurement	Actual Obligations	FY 1983 Commitments
FY 1981:			
	Design	$ 1,202,000	
Subtotal FY 1981		$ 1,202,000	
FY 1982:			
	Safety & Risk Analysis	$ 400,000	
	Design	13,926,000	
	Temporary Power	250,000	
	Land	24,864,000	
Subtotal FY 1982		$39,440,000	
	Safety & Risk Analysis	$ 179,329	
	Drill Casing	3,424,310	
	Drill Casing	1,106,999	
	Drill Casing	789,020	
	Drill Casing	253,326	
	Wellheads	1,307,130	
	Site Prep (Stage I)	677,000	$ 123,000
	Site Prep (Stage II)		2,800,000
	Circuit Switch Gear		429,000
	Main Transformer		1,162,000
	GSA Permanent Power	2,480,000	
	Force Contractor		150,000
	Site Construction		66,658,000
	Drill Rigs	10,600,000	
	Offshore Monitoring	200,000	
Subtotal FY 1983		$21,018,914	$71,322,000
Grand Total		$61,660,914	$71,322,000

Total of obligations plus commitments
is $132,982,914.

Question: The Department reportedly had a fiscal year 1982 carryover of storage facility development and operations funds totalling some $78 million. This figure remained from total available funds of some 320 million, 100 thousand dollars. Did you in fact have such a carryover and, if so, why? For the record, please provide a breakdown of these carryover funds by program.

Answer: Total available resources for obligation in FY 1982 was $256.42 million in the on-budget Strategic Petroleum Reserve account. Of this total, $78 million was carried over to FY 1983; however, only $59.6 million was for storage facility development. Of this total, $39.6 million was in Phase III where a fourth quarter overturn of a deferral of $52.86 million did not allow sufficient time to obligate these funds as originally scheduled. The second largest carryover occurred in Phase II caused by a variety of factors including a revision to the configuration at the Bayou Choctaw site. The third largest carryover was the planned carryover of the remaining "on budget" fund to be used as a source of reprogrammable funds for paying land condemnation and contract settlement claims such as the Bannister reprogramming in FY 1982.

A breakdown of the FY 1982 carryover by program element appears below:

Unobligated Carryover from FY 1982
(dollars in thousands)

Program	FY 1982 Carryover
Planning	$ 2,908
Facilities:	
Phase I	534
Phase II	18,837
Phase III	39,572
Non-Phase	671
Subtotal	$59,614
Program Direction	2,771
On-Budget Oil	12,707
Total SPR On-Budget	$78,000

Question: Under Phase II construction, solution mining of new caverns commenced at Bryan Mound in March 1980, and at West Hackberry in May 1981. What percentage of completion are these two sites and when will work be complete?

Answer: As of April 1, 1983, Phase II cavern development at Bryan Mound which consists of 12 new storage caverns, was approximately 59 percent complete in terms of cumulative capacity created. Five of the 10 million barrel storage caverns have been completed and final fill of these caverns is in process. Phase II at Bryan Mound is scheduled to be completed in the first quarter of 1986.

As of April 1, 1983, Phase II cavern development at West Hackberry, which consists of 16 new storage caverns, was approximately 29 percent complete in terms of cumulative capacity created. Phase II at West Hackberry is scheduled to be completed in the last quarter of 1987.

Question: What is your projection of the total cost of Phase III under the assumptions of a total 600 million barrel fill and a total 750 million barrel fill, both by 1989?

Answer: The current Phase III plan provides for the expansion of the Strategic Petroleum Reserve to 750 million barrels of oil storage through the expansion of existing storage sites and the acquisition and development of one new site at Big Hill, Texas. The total estimated cost of completing Phase III by 1989 is $1,134 million (excluding oil cost).

A 600 million barrel program would involve the elimination of the proposed Big Hill storage site. Considering funds already spent or committed to the Big Hill project this fiscal year, the estimated cost of Phase III under a 600 million barrel program would be approximately $400 million (excluding oil cost).

SPR Employment

Question: For the record, please provide a breakdown of the number of employees by job description, at each SPR facility, including headquarters.

Answer: The following breakdown includes OTFTP:

STRATEGIC PETROLEUM RESERVE PROGRAM OFFICE

OFFICE	TITLE
OFFICE OF THE DAS	1 Deputy Assistant Secretary
	1 Deputy Director
	2 Secretary (Steno)
Executive Office	1 Program Analysis Officer
	6 Program Analysts
	1 Admin. Svcs. Assistant
	2 Secretary (Typing)
	1 Clerk Stenographer
	1 Clerk Typist
	1 Clerk
SYSTEMS DIVISION	1 Director
	1 Secretary (Steno)
	1 Clerk Typist
Technical Branch	1 Branch Chief
	2 Geologists
	1 Tech. Spec. for Fossil Energy
	1 General Engineer
	1 Chemist
Logistics Branch	1 Branch Chief
	1 Operations Research Analyst
	1 Petro Log. Specialist
	1 Logistics Mgmt. Spec.
	1 Industry Mgmt. Spec.
	1 Secretary (Typing)
PLANNING AND FINANCIAL MANAGEMENT DIVISION	1 Director
	1 Secretary (Steno)
Planning Branch	1 Branch Chief
	2 Operations Research Analysts
	1 Industry Economist
	4 Program Analysts
	1 Policy Analyst
	1 Secretary (Steno)
	1 Clerk Typist
Financial Management Branch	1 Branch Chief
	1 Financial Res. Mgmt. Spec.
	1 Resource Mgmt. Spec.
	2 Budget Analysts
	1 Clerk Typist
	1 Secretary (Typing)

STRATEGIC PETROLEUM RESERVE PROJECT MANAGEMENT OFFICE

OFFICE	TITLE
OFFICE OF THE PROJECT MANAGER	1 Project Manager
	1 Deputy Project Manager
	1 Secretary (Typing)
Project Planning and Control Staff	1 Director
	1 General Engineer
	2 Program Analyst
	1 Computer Spec.
	1 Secretary (Steno)
ASSISTANT PROJECT MANAGER-TECHNICAL ASSURANCE	1 Director
	1 Secretary (Typing)
Environmental, Safety & Health Division	1 Director
	1 Oceanographer
	2 Environmental Protection Spec.
	1 Fire/Safety Engineer
	1 Safety Specialist
	1 Safety & Occupation Health Spec.
	1 Secretary (Typing)
Quality Assurance Division	1 Director
	4 Quality Assurance Specialist
	1 Mechanical Engineer
	1 Secretary (Typing)
ASSISTANT PROJECT MANAGER-MANAGEMENT & ADMINISTRATION	1 Assistant Project Manager
	1 Business Management Officer
	1 Secretary (Steno)
Administration Division	1 Director
	1 Management Services Spec.
	1 Personnel Officer
	2 Management Assistants
	1 Secretary (Steno)
	1 Personnel Assistant (Typing)

STRATEGIC PETROLEUM RESERVE
PROJECT MANAGEMENT OFFICE

OFFICE	TITLE
Procurement Division	1 Director 1 Procurement Analyst 1 Secretary (Typing)
Operations Contracting Branch	1 Chief 5 Contract Specialist 1 Procurement Clerk (Typing)
Facility Development Contracting Branch	1 Chief 4 Contract Specialist 1 Procurement Clerk (Typing) 1 Procurement Assistant (Typing)
Contracts & Property Management Branch	1 Chief 2 Industrial Property Management Spec. 2 Procurement Assistant 1 Procurement Clerk (Typing)
Finance Division	1 Director 1 Secretary (Typing)
Budget & Financial Services Branch	1 Chief 4 Budget & Financial Services Spec. 1 Budget Analyst 1 Financial Specialist
Accounting Branch	4 Operating Accountants 2 Accounting Technicians 1 Voucher Examiner 1 Clerk Typist
ASSISTANT PROJECT MANAGER-OPERATIONS	1 Assistant Project Manager 1 General Engineer 1 Secretary (Typing)
Security & Communications Division	1 Security Officer 4 Security Specialists 1 Communications Specialist 1 Security Clerk (Typing)
O&M Plans & Readiness Division	1 Director 2 Logistics Management Specialists 1 General Engineer 1 Industrial Maintenance Management Spec. 1 Industrial Specialist 1 Secretary (Typing)
Site Operations Division	1 Site Operations Manager 1 Petroleum Engineer (Drilling) 1 Secretary (Steno)
Seaway Branch Bryan Mound	1 Site Operations Manager 1 Site Operations Specialist 1 General Engineer (Cavern Operations) 1 Clerk Steno

STRATEGIC PETROLEUM RESERVE
PROJECT MANAGEMENT OFFICE

OFFICE	TITLE
Texoma Branch	1 Branch Chief
West Hackberry	1 Site Operations Specialist
Sulphur Mines	1 Assistant Resident Engineer
	1 Clerk Typist
Capline Branch	1 Site/Terminal Operations Manager
St. James, Weeks Island	2 Site/Terminal Operations Specialist
Bayou Choctaw	2 Resident Engineers
	1 Construction Representative
	3 Clerk Steno
Site Utilization & Maintenance Support Branch	1 Chief
	3 Site Operations Specialists
	2 Industrial Maintenance Management Specs.
	1 Secretary (Typing)
Crude Oil Programming Division	1 Director
	1 Logistics Management Specialist
	1 Transportation Specialist
	1 Traffic Management Specialist
	2 Accounting & Inventory Management Specs.
	1 General Supply Specialist
	1 Secretary (Steno)
ASSISTANT PROJECT MANAGER-ENGINEERING & CONSTRUCTION	1 Assistant Project Manager
	1 General Engineer
	1 Secretary (Steno)
Construction Division	1 Director
	1 Realty Specialist
	4 General Engineers
	1 Engineering Technician
	2 Secretary (Typing)
Design Engineering Division	1 Director
	2 Secretary (Steno)
Site Engineering Support Branch	1 Mechanical Engineer
	2 Electrical Engineers
	1 Petroleum Engineer
Systems Engineering Division	1 Director
	2 General Engineers
	1 Geologist
	1 Secretary (Steno)

Object Class Data

Question: Please provide for the record a summary of requirements by object class for each of SPR's budget line items. Copies of similar information provided by the U.S. Geological Survey for you to use as examples of what is needed is being provided. Likewise, please provide for the record line item information concerning program, financing and personnel. Again, examples of what is needed will be provided.

Answer: The following is provided for the record:

Strategic Petroleum Reserve Object Class
by Budget Line Item
(dollars in thousands)

Appropriation: Strategic Petroleum Reserve

Budget Line Item: Storage Facilities Development

	FY 1984 Base 1/		FY 1984 Estimate		Inc. (+) or Dec. (-)	
Direct Obligations:	FTE	Amount	FTE	Amount	FTE	Amount
32.0 Lands and Structures	0	224,742	0	199,757	0	- 24,985

Appropriation: Strategic Petroleum Reserve

Budget Line Item: Petroleum Acquisition and Transportation

	FY 1984 Base 1/		FY 1984 Estimate		Inc. (+) or Dec. (-)	
Direct Obligations:	FTE	Amount	FTE	Amount	FTE	Amount
25.0 Other Services	0	12,707	0	0	0	- 12,707

Appropriation: Strategic Petroleum Reserve

Budget Line Item: Planning

	FY 1984 Base 1/		FY 1984 Estimate		Inc. (+) or Dec. (-)	
Direct Obligations:	FTE	Amount	FTE	Amount	FTE	Amount
25.0 Other Services	0	10,908	0	6,250	0	- 4,658

1/ FY 1983 appropriation

Appropriation: Strategic Petroleum Reserve

Budget Line Item: Management

Direct Obligations:		FY 1984 Base 1/		FY 1984 Estimate		Inc. (+) or Dec. (-)	
		FTE	Amount	FTE	Amount	FTE	Amount
11.0	Personnel Compensation:						
11.1	Full-Time permanent	179	7,196	179	7,200	0	+ 4
11.3	Other than full-time permanent	19	427	19	457	0	+ 30
11.5	Other personnel compensation	2	60	2	118	0	+ 58
11.9	Total personnel compensation	200	7,683	200	7,775	0	+ 92
12.1	Personnel benefits Civilian		724		791		+ 67
21.0	Travel and transportation of persons		539		647		+ 108
22.0	Transporation of things		245		110		- 135
23.2	Communications, utilities and other rent		1,384		797		- 587
24.0	Printing and reproduction		40		43		+ 3
25.0	Other services		3,697		0		- 3,697
26.0	Supplies and materials		48		0		- 48
99.9	Total Obligations	200	14,360	200	10,163	0	- 4,197

1/ FY 1983 appropriation

Strategic Petroleum Reserve
Object Classification
(in thousands of dollars)

Identification code 89-0218-0-1-274		1982 actual	1983 est.	1984 est.
	Personnel compensation:			
11.1	Full-time permenent	6,577	7,196	7,200
11.3	Other than full-time permanent	321	427	457
11.5	Other personnel compensation	55	60	118
11.9	Total Personnel compensation	6,953	7,683	7,775
12.1	Personnel benefits: Civilian	703	724	791
13.0	Benefits for former personnel	17	....	....
21.0	Travel and Transportation of persons	435	539	647
22.0	Transportation of things	39	245	110
23.2	Communication, utilities and other rent	2,141	1,384	797
24.0	Printing and reproduction	38	40	43
25.0	Other services	9,989	27,312	6,250
26.0	Supplies and materials	7	48	....
32.0	Lands and structures	158,108	224,742	199,757
99.9	Total obligations	178,430	262,717	216,170

Strategic Petroleum Reserve
Program and Financing
(in thousands of dollars)

Identification code 89-0218-0-1-274		1982 actual	1983 est.	1984 est.
	Program by activities:			
	1. Storage facility development	158,108	224,742	199,757
	2. Petroleum acquisition and transportation	232	12,707	....
	3. Planning	8,789	10,908	6,250
	4. Management	11,291	14,360	10,163
10.00	Total obligations	178,420	262,717	216,170
	Financing:			
21.40	Unobligated balance available, start of year	-64,987	-77,999	-57,400*
24.40	Unobligated balance available, end of year	77,999	57,400*	....
40.00	Budget authority (appropriation)	191,432	242,118	158,770
	Relation of obligations to outlays:			
71.00	Obligations incurred, net	178,420	262,717	216,170
72.40	Obligated balance, start of year	1,914,339	131,657	110,517
73.40	Obligated balance transfered, net	- 1,771,100	....	....
74.40	Obligated balance, end of year	-131,657	-110,517	-99,087
77.00	Adjustments in expired accounts	698	....	....
90.00	Outlays	190,700	283,857	227,600

* These amounts were included in the President's budget and reflected the deferral of some FY 1983 Phase III funding. This deferral was overturned by the House in March. The majority of these funds will therefore be obligated in FY 1983.

Strategic Petroleum Reserve
Personnel Summary

Total Number of Full-time permanent positions	184	179	179
Total compensable workyears:			
Full-time equivalent employement	199	200	200
Full-time equivalent of overtime and holiday hours	2	2	2
Average ES salary	$55,940	$56,376	$56,376
Average GS grade	12.01	12.01	12.13
Average GS salary	$36,429	$37,154	$38,217

Strategic Petroleum Account
Program and Financing
(in thousands of dollars)

Identification code 89-0233-0-1-274		1982 actual	1983 est.	1984 est.
	Program by activities:			
	Direct program: Petroleum acquisition and transportation	3,376,513	2,381,547	583,100
	Reimbursable program	300,000	....	....
10.00	Total obligations (object class 25.0	3,676,513	2,381,547	583,100
	Financing:			
11.00	Offsetting collections from Federal Funds	-300,000	....	....
21.40	Unobligated balance available, start of year	....	-307,487	....
24.40	Unobligated balance available, end of year	307,487	....	....
40.00	Budget authority (appropriation)(general fund)	3,684,000	2,074,060	583,100
	Relation of obligation to outlays:			
71.00	Obligations incurred, net	3,376,513	2,381,547	583,100
72.40	Obligated balance, start of year	....	1,494,785	2,105,732
73.40	Obligated balances transfered, net	1,804,924	....	....
74.40	Obligated balance, end of year	-1,494,785	-2,105,732	-822,432
77.00	Adjustments in expired accounts	-1	....	....
90.00	Outlays	3,686,651	1,770,600	1,866,400

Strategic Petroleum Account

Object Classification

All funds in this account are Object Class 25.0, Other Services.

Personnel Summary

No personnel are requested or funded in this account.

Futures Contracts for SPR Oil

Question: On April 8, 1983, a notice in the Federal Register indicated that the Department of Energy is considering a plan to sell "futures contracts" now for delivery of SPR oil later during some energy supply emergency. I recognize that this proposal is still out for public comment, but would you please describe how these futures contracts would be designed — who would you expect to bid on them (just the majors or small speculators as well?), what might be the minimum size delivery, what safeguards would be installed to prevent any one company or family of companies from acquiring a dominant share of the Reserve, and how much of the reserve might actually be put up for "sale"?

Answer: Many factors, objectives and circumstances must be taken into account in reaching a decision on how SPR futures contracts would be designed. The specifics of any forward sales procedure for SPR drawdown has not been developed to date. We plan to use the public responses to the Federal Register notice of April 8, 1983, in determining whether such mechanisms would be desirable. In addition, Harvard, under contract to DOE, has examined the benefits of pre-crisis sales of SPR oil and will continue to evaluate various SPR forward sales mechanisms.

Question: What authority do you presently have to sell SPR oil under a "futures" arrangement or to acquire and store oil in the future under this kind of arrangement?

Answer: A "futures" contract ordinarily is understood to involve a definite commitment to deliver oil at a time certain in the future. The Energy Policy and Conservation Act (EPCA) provides in section 161(d) that the SPR cannot be drawn down "unless the President has found that implementation of the SPR Distribution Plan is required by a severe energy supply interruption or by obligations of the United States under the international energy program." This requirement makes it impermissible, within the scope of existing legal authority, for the Government to sell "futures" contracts on SPR oil in advance of a SPR drawdown.

We find nothing in the EPCA or in other law that, in principle, would prevent the purchase of oil for storage in the SPR through "futures" contracts, so long as the award of such contracts and their provisions are consistent with applicable laws governing Federal procurement and the use of appropriated funds. However, EPCA section 160(c)(1) imposes certain requirements for current fiscal year fill of the SPR at a "minimum required fill rate"; these requirements have been analyzed by the DOE General Counsel in an opinion of March 8, 1983, a copy of which is enclosed. Any use of available appropriations to acquire oil for future storage in the SPR would have to be consistent with these requirements governing SPR oil storage in the current fiscal year.

Question: How do you envision that a "futures sale" would result in the least cost to the consumer or to the American taxpayer during an oil supply shortage? What analyses have you conducted to support this conclusion? Please provide copies of these analyses for the record?

Answer: We have not completed our analysis of "futures sale" of SPR oil including costs to the consumer. However, one analysis conducted by Harvard supports this conclusion. Their paper entitled "Drawing Down the Strategic Petroleum Reserve: The Case For Selling Futures Contracts" by Devarajan and Hubbard, June 1982, indicated that by guaranteeing supplies to the market during a disruption, the futures sale lowers expected future profits from speculation. This, in turn, reduces inventory demand and prevailing spot prices.

A copy of this paper is provided for the record.

Question: Is this "futures" concept simply a mechanism to reduce federal budgetary costs now to reduce the deficit or can it be justified by other reasons?

Answer: Presently, the "futures" concept referenced in the DOE notice published in the Federal Register on April 8, 1983, is not envisioned as a mechanism to reduce federal budgetary costs or deficits. The "futures" concept arose from a concern on the timing of an SPR drawdown decision and the amount of time it would take for SPR volumes introduced into the marketplace to have their impact. DOE hopes to gain insight into these merits as well as others based on the public response to the recent Federal Register notice.

Question: Given the sharp decline in petroleum prices in recent months and the present excess supply conditions and the fact that the nation is still in a recession, is this the right environment to maximize government income from these "future" sales?

Answer: The ability of the government to maximize income from SPR "futures" sales would depend on the specifics of the "futures" mechanism to be used and the incentives for the market to participate in such sales under various market conditions. Currently, DOE is in the process of determining these factors. It is anticipated that the public response to the recent Federal Register notice will provide some insight into the determination of these factors.

Question: When asked for the record whether the Department intends that conditions be imposed on the sale of SPR oil so as to avoid hoarding of, or speculation with, SPR oil, you responded that—

> "DOE has no present plans to impose contractual requirements on SPR oil buyers that they refine the oil within a specified period of time or sell the resulting products. Once private party has taken delivery of SPR oil, decisions as to the use of that oil are within the discretion of that purchaser."

In other words DOE does not intend to take steps to avoid hoarding, would you comment?

Answer: It is DOE's position that the marketplace can best determine how and when oil should be refined and the resulting product sold. DOE, of course, will be alert to deliberate attempts to interfere with the SPR program objectives, and will take such responsive actions as may be appropriate.

SPR Fill Rate

Question: Under The President's budget you do not plan to reach 500 million barrels of storage until the middle of fiscal year 1987. This compares to mid 1985 under the statutory mandate to fill at 220,000 barrels per day. Since you have a statutory mandate to fill at 220,000 barrels per day, on what basis do you justify not complying with the law?

Answer: This Administration does not intend to ignore applicable law. However, the Energy Emergency Preparedness Act provisions for establishing minimum SPR fill rates make such fill rates dependent on the availability of funds. Thus, the President and the Congress have the responsibility to reexamine SPR fill rates periodically as a part of the budget process. The Administration is following these procedures in proposing the fill rates associated with the President's FY 1984 budget. The fill rates in FY 1984 and future years will be dependent on the final resolution of the FY 1983 fill rate question as well as on appropriations enacted by the Congress.

Question: If the Administration does not support the mandated 220,000 barrels per day then why do you not propose legislation to change this statutory mandate rather than use the appropriations process to circumvent the law?

Answer: The amendments to the Energy Policy and Conservation Act specifying a minimum SPR fill rate are applicable "to the extent funds are available" and "subject to the availability of funds." If appropriations are insufficient to pay for a 220,000 barrels per day rate, then the fill rate may be lower than 220,000 barrels per day. As provided in the amendments, the appropriations process is a means to determine the fill rate. We are working through the existing channels as provided by the Congress.

SPR Distribution Plan

Question: Under section 161(b) of EPCA any drawdown and distribution of the Reserve must be "in accordance with the provisions of" the SPR Distribution Plan. Yet in your answers to questions for the record at the Energy Committee you stated that "a failure to mention some otherwise applicable Congressionally enacted authority has no effect on the availability of that authority in case of a SPR drawdown and distribution in accordance with the provisions of the Distribution Plan." These statements appear inconsistent to me. Would you explain why they are not?

Answer: The only reference in the Energy Policy and Conservation Act to the required content of the SPR Distribution Plan is section 154(e)(12), which states that the Distribution Plan shall set forth "the method of drawdown and distribution of the Reserve." Existing law does not require an enumeration, in the Distribution Plan, of legal authorities which may be relied upon in the course of SPR drawdown and distribution. Therefore, an omission of reference to a particular statute does not render the statute inapplicable to drawdown and distribution. Of course, all available legal authorities must be utilized in a manner that is harmonious with the provisions of the effective Distribution Plan and with the purposes and limitations pertaining to those authorities.

Question: When asked how DOE proposes to make any SPR oil available to meet "hardship" or "exceptional" cases, the Department has indicated that the SPR Distribution Plan does not permit the direct sale of SPR oil unless competitive sales also take place during the month.

The Department also has indicated that in order to undertake direct sales with 10 percent of any months sales the Department must simultaneously make available by competitive sale the other 90 percent of any months sales whether or not needed to respond to the energy emergency.

Would you agree?

Answer: It is correct that the SPR Distribution Plan does not permit the direct sale of SPR oil unless competitive sales also take place during the month. However, in order to draw down the SPR, the President must make a finding of a severe energy supply interruption or of a need to fulfill U.S. obligations under the Agreement on an International Energy Program, whose sharing system is triggered by an emergency. Whatever amount is drawn down will be needed to respond to the emergency. The situation in which there is a local hardship case without a severe widespread shortage would be handled through the marketplace, not through drawing down the SPR.

Question: This would suggest that the SPR is effectively not available to meet "hardships" or even IEA fair sharing obligations. Would you comment?

Answer: We do not agree. The SPR Distribution Plan gives the Secretary of Energy discretion to sell at competitive prices up to 10 percent of the volumes drawn down in any calendar month in such manner as he finds necessary in order to meet hardship situations. Directed sales could be made to U.S. oil companies to replace oil diverted to other countries.

Question: When asked how the SPR Drawdown Plan would be responsive to the needs of Defense, IEA partners, and other critical economic sectors, the Department responded:

"The SPR Distribution Plan permits up to 10 percent of the oil drawn down from the SPR to be directed to meet critical requirements, including, for example, defense needs, U.S. company fulfillment of International Energy Program obligations, or agriculture. In this sense, agriculture is treated equally."

In this sense, agriculture and Defense and IEA Program obligations must be satisfied from the 10 percent of any months sales set aside for directed sales. Is this correct?

Answer: No. The SPR "Drawdown" Plan has eliminated the restriction on who can purchase SPR oil. Therefore, agriculture, Defense and IEA participating companies could all bid on SPR oil and obtain critical supplies.

Question: The DOE has indicated that "Some initial analytical work has been done on the benefits of pre-crisis sales of rights to SPR oil, and further work on alternate types of forward sales (e.g., options, futures, competitive bid/forward delivery) is currently being done under contract to DOE by Harvard University. What is the schedule of this effort?

Answer: It is expected that the Harvard work on this subject will be completed by September 30, 1983.

Question: What is your statutory authority for this proposal? Could any of these possibilities be implemented under current authority? Under the current Drawdown Plan?

Answer: Whether any particular system of advance contracting with respect to SPR oil sales is authorized by law, or within the scope of the currently effective SPR Distribution Plan, will depend upon the specific details of that system, and cannot be answered in the abstract. Some such methods may be permissible under current legal authorities, while other methods may not be. For example, in anticipation of a possible Presidential drawdown finding under section 161(d) of the Energy Policy and Conservation Act (EPCA), we believe it would be consistent with governing law and with the new Distribution Plan, to proceed to issue a notice of sale of SPR oil, conduct a price competitive sale, and award contingent sales contracts, which, however, would not become effective unless and until the President decided to draw down the SPR. And we think that authority exists under the EPCA to contract for forward sales of SPR oil, following a Presidential decision to draw down and distribute the SPR, if policy or programmatic reasons suggest the desirability of doing so. However, as noted in answer to a previous question, a SPR oil sales system involving the commitments to sell and deliver SPR oil at a time certain, even though no drawdown was then authorized under section 161, clearly is not permitted by existing law; neither is it within the scope of the SPR Distribution Plan. Other possible methods of pre-drawdown SPR contracting would need to be evaluated on the merits of the particular proposals.

Question: Would you provide, for the record, a legal analysis to support your conclusion that you already have sufficient authority?

Answer: As explained above, whether DOE's authority is adequate necessarily depends upon the particulars of a specific proposal for advance contracting.

IEA Emergency Sharing System

Question: You state that during 1984 support and analysis of IEA activities will include development of procedures to facilitate U.S. Company participation in the Emergency Sharing System of the IEA.

But in the Department's answer three weeks ago to questions for the record it was stated that "no decisions have been made as to whether fair sharing is needed or how such a program would be implemented." Has that decision now been made?

Answer: No. The Department has not as yet completed the fair sharing study.

Question: Does your testimony today mean that that decision is unlikely to be made for another year?

Answer: No. We hope shortly to resolve this issue. At present, we are participating in the IEA's Fourth Allocation System Test and will review the necessity of fair sharing in the context of the Test.

Question: You are currently undertaking the AST-4 Test. It has been reported to Committee staff that some oil companies are unlikely to participate in the Test unless it includes "fair sharing." Is this correct?

Answer: No. All U.S. oil companies that are signatories to the Voluntary Agreement are participating in AST-4. In addition, we have asked other U.S. oil companies to participate in the Test, and a number of them have, at least to some extent.

Question: Do you plan to include "fair-sharing" in the AST-4 test?

Answer: DOE has identified a number of "fair-sharing" options for use in the test should the need arise.

Object Class Data

Question: Please provide for the record a summary of requirements by object class for each of Emergency Preparedness' budget line items. Copies of similar information provided by the U.S. Geological Survey for you to use as examples of what is needed is being provided. Likewise, please provide for the record line item information concerning program, financing and personnel. Again, examples will be provided.

Answer: The requested information is provided on the following tables:

DEPARTMENT OF ENERGY
EMERGENCY PREPAREDNESS 1/
EMERGENCY PREPAREDNESS AND ENERGY REGULATION
Program and Financing (in thousands of dollars)

		FY 1982 Actual 2/	FY 1983 Estimate	FY 1984 Estimate
Program by activities:				
1.	Energy Emergencies	7,760	6,852	5,230
2.	Gasoline Rationing	137	-	-
10.00	Total obligations	7,897	6,852	5,230
Financing:				
17.00	Recovery of prior year obligations..................	-763	-101	-
21.40	Unobligated balance available, start of year...............	-6,035	-4,913	-1,650
23.40	Unobligated balance transferred to other accounts...........	3,000	1,877	-
24.40	Unobligated balance available, end of year.................	4,913	1,650	1,650
25.00	Unobligated balance lapsing...	1,033	-	-
	Budget authority...........	10,045	5,365	5,230
Budget authority:				
40.00	Appropriation.................	10,045	5,190 3/	5,230
44.20	Supplemental for civilian pay raise.......................	-	175	-
Relation of obligations to outlays:				
71.00	Obligations incurred, net.....	7,897	6,852	5,230
72.40	Obligated balance, start of year:..............	7,753	5,918	2,977
74.40	Obligated balance, end of year.................	-5,918	-2,977	-1,423
77.00	Adjustments in expired accounts	-384	-	-
78.00	Adjustments in unexpired accounts....................	-763	-	-
90.00	Outlays, excluding pay raise supplementals...............	8,585	9,623	6,779
91.20	Outlays from civilian pay raise supplemental..........	-	170	5

1/ Includes funds appropriated in the Departmental Administration, Energy Conservation and Atomic Energy Defense Activities appropriations.

2/ In many cases, actual data is not available to the level of detail requested; estimates have been made when necessary.

3/ Excludes $250,000 for permitting of international transmission facilities. This activity has been transferred to the Economic Regulatory Administration.

DEPARTMENT OF ENERGY
EMERGENCY PREPAREDNESS
EMERGENCY PREPAREDNESS AND ENERGY REGULATION
OBJECT CLASSIFICATION (in thousands of dollars)

		1982 Actual	1983 Estimate	1984 Estimate
Personnel compensation:				
11.1	Permanent positions............	4,396	2,975	2,975
11.3	Positions other thon permanent	68	34	34
11.5	Other personnel compensation....	20	25	25
	Total personnel compensation	4,484	3,034	3,034
Personnel benefits:				
12.1	Civilian.........................	436	332	332
13.0	Benefits for former personnel...	137	-	-
21.0	Travel and transportation of persons.......................	58	200	200
22.0	Transportation of things........	15	31	31
23.0	Rent, communication and utilities......................	488	436	436
24.0	Printing and reproduction.......	-	35	35
25.0	Other services..................	1,383	2,729	1,107
26.0	Supplies and materials..........	46	55	55
31.0	Equipment.......................	850	-	-
99.0	Total obligtions............	7,897	6,852	5,230

PERSONNEL SUMMARY

Total number of Full-time permanent positions	83	70	70
Total compensable workyears:			
Full-time equivalent employment	104	72	62
Full-time equivalent of overtime and holiday hours	.2	1	1
Average ES salary	$57,439	$56,181	$58,500
Average GS grade	12.89	12.89	12.89
Average GS salary	$39,998	$41,598	$44,776

DEPARTMENT OF ENERGY
EMERGENCY PREPAREDNESS

Summary of Requirements by Object Class
(Dollar amounts in thousands)

Appropriation: Emergency Preparedness and Energy Regulation

		FY 1984 Base		FY 1984 Estimate		Inc. (+) or Dec. (-)	
		FTE	Amount	FTE	Amount	FTE	Amount
Direct Obligations:							
11.0	Personnel Compensation:						
11.1	Full-time permanent	---	2,975	---	2,975	---	---
11.3	Other than full-time permanent	---	34	---	34	---	---
11.5	Other personnel compensation	---	25	---	25	---	---
	Total personnel compensation	71	3,034	72	3,034	+1	---
12.1	Personnel benefits		332		332		---
13.0	Benefits for former personnel		---		---		---
21.0	Travel & transportation of personnel		200		200		---
22.0	Transportation of things		31		31		---
23.0	Rents, communications and utilities		436		436		---
24.0	Printing and reproduction		35		35		---
25.0	Other Services		2,729		1,107		-1,622
26.0	Supplies & materials		55		55		---
31.0	Equipment						
	Total requirements		6,852		5,230		-1,622

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DRAWING DOWN THE STRATEGIC PETROLEUM RESERVE: THE CASE FOR SELLING FUTURES CONTRACTS

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The views expressed in this study are those of the authors and do not necessarily reflect those of the Energy and Environmental Policy Center or Harvard University.

I. Introduction

That the oil shocks of the 1970s contributed to a host of economic woes faced by the United States and its OECD partners is by now well known. Several studies have pointed out that rapid and discontinuous changes in the price of oil, a major input to the economy's production process, can create problems of a special nature (see, for example, Eckstein [1979], Hubbard and Fry [1982], and Mork and Hall [1980]). Perhaps less well known is the fact that the price increase caused by the supply disruption is typically heightened by the role of private crude oil inventories (see Danielson and Selby [1980] and Verleger [1982]). Driven by uncertainty over future supplies and the expectation of profits from still higher prices in the future, private inventory accumulation at the onset of the disruption augments world oil demand, putting further upward pressure on oil prices.

Many policy responses have been put forth to combat the problems of the price spike attendant to a supply disruption. Tariffs and drawing-down the Strategic Petroleum Reserve (SPR) are two of the most prominent. The former discourages oil consumption directly by raising the price faced by consumers, while the latter increases the available supply of oil in the world market. Both would reduce the effective demand for OPEC oil, exerting downward pressure on oil prices. Neither of these, however, addresses the issue of private inventory build-up during the disruption.

To the extent that private inventory accumulation has contributed to the great price increases during disruptions, it is desirable to obtain policy instruments which could manipulate private sector stockpiling. In this paper, we analyze one such instrument, namely, the sale of futures contracts in SPR oil. Using a simple, analytical model, we show in Section II how the existence of SPR futures contracts could dampen private inventory demand by guaranteeing future supplies. In addition, futures market sales are compared with direct, spot market sales and conditions under which the former is more effective in blunting the price increase are derived. In Section III, we take the first steps towards quantifying our model by examining a special and empirically tractable case of the link between demand pressures and world oil prices. This, in turn, enables us to simulate a disruption in the world oil market in Section IV, and compare the effects of futures and spot market sales of SPR oil during the disruption. Finally, in Section V, we summarize the salient points and consider the implications of our results for policy.

II. Why Futures and Not Spot Market Sales of the SPR?

To make the case for futures market sales of SPR oil, it is important to examine first the rationale behind the private inventory behavior during a disruption. Economic optimization suggests that the speculative component of stocks be built when expected future prices are high relative to today's price, and drawn down when expected future prices are low. Since rising future prices can be identified with "disrupted" markets, the observed accumulation of private inventories is hardly surprising.

However, because the social cost of imported oil is not taken into account by firms, unregulated private inventory behavior is likely to be socially suboptimal. When the fact that, during a disruption, the spot market price acts as a trigger for various crisis-level activities is taken into account, the case for government intervention to keep the spot price down becomes all the more compelling.

The link between expected future prices and speculative hoarding mentioned earlier provides an opportunity for policy intervention if the government can manipulate price expectations. This is where the SPR can play a role. The announcement of an SPR drawdown strategy for the future lowers expected future profits from speculation. This, in turn, reduces inventory demand and spot prices today. Of course, the success of this intervention depends on how credible the announced SPR drawdown strategy is. By selling futures contracts, the government can guarantee that a specified amount of SPR oil will be available at a certain time in the future. Thus, instead of its traditional risk-sharing role, the futures contract here plays the role of a credible guarantor of the government's SPR drawdown policy.

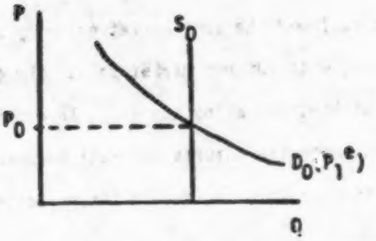
Now, the government can also lower the spot market price by selling SPR oil in the spot market. However, with futures market sales, the government is depressing the spot prices without releasing any oil. In addition, when this oil is released -- that is, when the futures contract becomes due -- the spot price in that period is also lowered, due to the presence of SPR oil on the market.

Under a regime of futures SPR sales, therefore, the trajectory of spot prices, will at the very least, be different from that under spot sales of the reserve. To make the case for futures contracts, though, we must show that they result in a sequence of spot prices which is in some sense preferable to the sequence generated by spot sales. Using a two-period model, we will show how much of the gains in spot-price reduction in the first period are achieved by futures sales. Moreover, the spot price in the second period is unambiguously lower under a futures contracts regime. Finally, as demonstrated in Section IV, the peak spot price during a year long interruption is lower when SPR futures are sold than when the oil is released onto the spot market.

Assume that spot market demand for oil depends not just on the spot price of oil, P_0, but also on the expected price one period into the future. Thus the inverse demand curve may be written P_1^e.

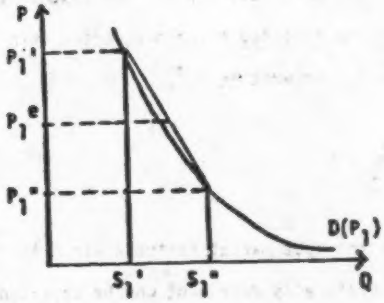
$$D = D(P_0, P_1^e),\ D_1 < 0,\ D_2 > 0.$$

Assume further that supply in the spot market is inelastic. The market-clearing spot price of oil therefore is dependent on the expected future price, P_1^e:



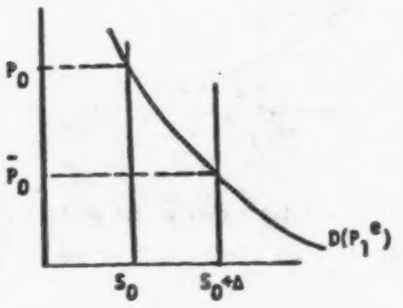
How are expectations of future prices formed? We assume that all agents have access to the same information and hence share common expectations of future events and their probabilities. Then, the expected future price is simply the mathematical expectation of the distribution of spot prices one period into the future. If we assume the demand curve is the same in both periods, then this distribution of spot prices is determined by the (inelastic) supply curves in the future period. For example, if supply will be S_1' or S_1'' with equal probability, then

$$P_1^e = \frac{1}{2}(P_1' + P_1'')$$

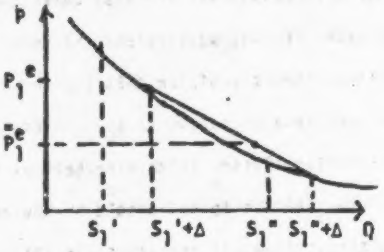


Note that, with a convex demand curve, P_1^e is higher than the price which would prevail if $\frac{1}{2}(S_1' + S_1'')$ is expected to occur with certainty. Thus, the uncertainty surrounding future supply has an upward effect on the expected price independently of the magnitude of that supply.

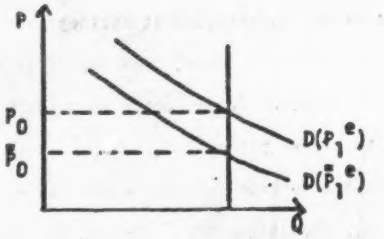
We are now in a position to examine the differential impacts of spot and futures market sales of the SPR. First, we consider the impact on the spot price in period 0. If the government sells an amount Δ in the spot market, the direct effect is an increase in supply to $S_0+\Delta$. This lowers the spot market price. The sale may affect future price expectations to the extent that agents expect some of the SPR oil to be re-sold in the next period. However, since the oil was bought by private firms, there is still uncertainty about how much of the Δ barrels will be sold and, in particular, Δ represents the upper-bound on the additional amount available in the future period. As a first approximation, we assume that the distribution of future supplies (and hence prices) is unaffected by the spot sales. The resulting spot market price, $\bar{P}_0$, therefore, is depicted as follows:



We can compare this now with the sale of Δ barrels worth of crude oil futures, for delivery one period from now. In this case, the entire distribution of future supplies is translated by the amount Δ, unambiguously lowering the expected price (and leaving the variance unchanged).



The lower expected price $\bar{P}_1^e$, in turn, will shift the spot market demand curve down, resulting in a spot market price $\bar{P}_0$ which is lower than P_0:



Thus, the benefits of a futures over a spot market sale depends on how the combined effects of a translation by Δ of the distribution of future supplies on the expected price and the attendant shift in spot demand stack up against the direct effect of an increase in Δ of spot market supply.

If we relax our assumption that spot market sales of the SPR leave the expected future price unaffected, then the spot price $\bar{P}_0$ will be slightly lower. However, the expected future price under SPR spot sales, $\bar{P}_1^e$, will always be higher than $\bar{P}_1^e$, the expected future price under futures sales. This is so for two reasons. First, the mean of the distribution of future supplies is greater under a futures regime than under spot sales, since the former shifts the mean by Δ whereas the latter shifts the mean by the expected fraction of Δ which will be stored and sold in the next period. Second, the sale of SPR oil in the spot market increases the variance of future prices whereas a futures contract will leave this variance unaffected. Quite simply, since private firms are buying the SPR oil in the spot market, there is uncertainty about when, and how much, of this oil will be resold in the next period. By contrast, a futures sale will guarantee that an amount Δ will be sold in the next period. As we pointed out earlier, owing to the (plausibly) convex shape of the demand curve, this increased variance has the effect of increasing the expected future price when compared with a distribution with equal mean but lower price.

So far, we have contrasted futures and spot market sales of the SPR in terms of their effects on P_0, the spot price in period 0. What about their effects on P_1, the period 1 (realized) spot price? Here, the results are unambiguous. If Δ barrels of crude oil futures become due in period 1, then period 1 supply is effectively increased by Δ. On the other hand, if Δ barrels were sold in the period 0 spot market, any amount up to Δ may be resold in period 1. Ceteris paribus, the period 1 spot price under a futures sales of the SPR is a lower bound on the spot price under spot sales of the reserve.

Another way of looking at the preceding analysis is that there is an asymmetry between spot and future sales of the SPR. By selling oil in the spot market, the government is lowering the spot price, but conveying little or no information about future availability of oil. By selling futures contracts, the government is lowering the mean while keeping the variance unchanged of future supplies of oil, in addition to lowering the spot price when the contracts become due. The net result is that the sale of SPR futures achieves a large part of the price reductions attributed to spot SPR sales in the early stages of a disruption, and achieves greater reductions in price in the later stages. The exact magnitude of these benefits will be presented in Section IV.

Before proceeding to the empirical corroboration of our results, however, we should point out that drawing down the SPR by selling futures contracts has several other advantages in addition to a more favorable spot price trajectory.

First, the sale of SPR futures permits the government to achieve significant benefits, in terms of a reduced spot price, before releasing a drop of oil from the strategic reserve. This is significant because, as many authors have stressed, delays in decision-making can be extremely costly during interruptions. To the extent that the decision to sell futures contracts is easier to take than the decision to draw down the SPR physically, the futures option buys time for the government.

Second, even when the contracts come due, the government may be able to avoid drawing oil from the reserve. If the interruption is over before the due date, the contracts would have been priced higher than the now normal spot market price. The government can meet its contractual obligation in this case by buying oil in the spot market and giving it to the holder of the futures contract. Alternatively, the government could just buy back the futures contracts. Even if the interruption is not over when the contracts mature, the government can purchase oil in the spot market to meet its obligations. Of course, this will lose the price-reducing benefits of the futures sales described earlier. However, it is worth noting that if for reasons of national security say, the government is reluctant to withdraw SPR oil, it need not do so under a regime of futures contracts.

Before stating the third advantage of futures sales of SPR oil, we show that the sale of SPR futures would yield an expected revenue loss to the government. Inasmuch as some speculative inventory accumulation occurs, the expected future price P_1^e cannot exceed, in present value, the current spot price, P_0 (neglecting storage costs):

$$P_0 < \frac{P_1^e}{1+r}$$

where r is the market discount rate. For there to be a market for futures, the price of a futures contract, f_0, cannot exceed the spot price (otherwise agents would buy oil in the spot market and store it themselves):

$$f_0 < P_0$$

Combining these two inequalities leads to the conclusion that f_0 is less than the present value of the expected future price, or that the seller of futures makes an expected loss in revenues.

The point to keep in mind, however, is that P_1^e represents an expectation over several events, including the possibility that the interruption will end before the market opens in period 1. If the latter occurs, the actual spot price will be low from the softer market and the government will have made a revenue gain. The third advantage of SPR futures sales, therefore, is that, while expected revenues are negative, the actual gains and losses occur in a politically attractive direction: the government makes money if the disruption ends quickly, and loses money if the disruption is prolonged.

Having established the qualitative nature of the benefits from sales of SPR futures, we turn now to estimating quantitatively the most important of those benefits, namely the lowered spot price trajectory during an interruption.

III. Empirical Analysis

In this section, we present the ingredients of a model of the world oil market which will be used to test alternative SPR drawdown strategies.

As with most economic models, we begin with the notion that spot prices are determined by the forces of supply and demand in the market. Since we wish to simulate market behavior during "normal" and "disrupted" times, we assume that the supply price of OPEC oil depends in part on the extent to which actual oil production approaches maximum sustainable production (capacity production).[1] Hence we have:

$$(1)\quad PSPOT_t = \psi/PSPOT_{t-1} + \beta f\left(\frac{OUTPUT_t}{CAPACITY_t}\right), \qquad f' > 0, \text{ where}$$

PSPOT represents the spot price, OUTPUT represents actual OPEC oil production, and CAPACITY represents capacity OPEC production. In "normal" times, then, spot prices rise when production is increased toward capacity (where such an increase is effected to meet the increased demand, under the assumption that OPEC is a residual supplier -- the supplier of the marginal barrel on the world oil market).

But what about a disrupted market? For the sake of simplicity, we could divide total OPEC production into that which is produced by nondisrupted members (OUTPUT, as before) and that which is produced by disrupted members (DISRUP). From (1), it is easy to see why spot prices rise during a disruption. The capacity production (CAPACITY) falls, since it is reduced by the capacity of the disrupted producer(s). The output of the remaining producers, OUTPUT, should increase to take advantage of the higher oil prices. The resulting increase in the capacity utilization ratio raises the spot price.

Given the assumption that OPEC is a residual supplier of oil, we can use the fact that at any time the total quantity of oil supplied must equal the quantity demanded to solve for OUTPUT in terms of, among other things, demand factors. Suppose we make the following simple decomposition of the (free) world oil market:

Free World Oil Demand and Supply

Demand =	Supply =
USCON (U.S. oil consumption demand)	OUTPUT (production by nondisrupted OPEC members)
+ NETCON (oil consumption demand in the rest of the free world)	+ DISRUP (production by disrupted OPEC members)
+ USSPR (U.S. oil demand for the Strategic Petroleum Reserve)	+ USOIL (U.S. oil production)
+ USPSTCH (U.S. private oil inventory demand)	+ NONUSOPEC (oil production in the free world outside of OPEN and the U.S.)
+ FSTCH (inventory demand in the rest of the free world)	

Thus,

(2) $$\mathrm{USCON} + \mathrm{NETCON} + \mathrm{USSPR} + \mathrm{USPSTCH} + \mathrm{FSTCH} = \mathrm{OUTPUT} + \mathrm{DISRUP} + \mathrm{USOIL} + \mathrm{NONUSOPEC}.$$

We can rearrange (2) to get:

$$(3)\quad \text{OUTPUT} = (\text{USCON} + \text{NETCON}) - (\text{USSPR} + \text{USPSTCH} + \text{FSTCH}) - (\text{DISRUP} + \text{USOIL} + \text{NONUSOPEC}).$$

So production of the nondisrupted OPEC producers is just world consumption demand plus world inventory demand less production from other producers. Substituting (3) back into (1) yields:

$$(4)\quad \text{PSPOT}_t = \psi\text{PSPOT}_{t-1} + + \beta f\,(\frac{\text{USCON}_t+\text{NETCON}_t)+(\text{USSPR}_t+\text{USPSTCH}_t+\text{FSTCH}_t)-(\text{DISRUP}_t+\text{USOIL}_t+\text{NONUSOPEC}_t)}{\text{CAPACITY}_t}.$$

To complete the analysis, we need to specify the demand relationships. Let:

$$(5)\quad \text{USCON} = h(p_{us}, y_{us}(p_{us}), \text{DMY}) \text{ and}$$

$$(6)\quad \text{NETCON} = j(P_{nus}, y_{nus}(p_{nus}), \text{DMY}), \text{ where:}$$

p_{us} = price of a marginal barrel of oil in the U.S.;

y_{us} = U.S. real income;

p_{nus} = price of a marginal barrel of oil outside the U.S.; and

y_{nus} = real income in the rest of the free world.[2]

DMY = seasonal factors

IV. Analyzing the Impact of SPR Behavior on the World Oil Market

In the simplest possible case, we consider world oil demand as essentially a scalar multiple of U.S. oil demand. We take FSTCH, DISRUP, USSPR, NONUSOPEC, and USOIL as exogenous. Oil consumption demand outside the U.S. (i.e. NETCON) is γUCSON. For ease of exposition, U.S. work-in-process inventory is a fixed fraction of consumption, say ωUSCON. Speculative inventory demand in the U.S. is a function k of the mean and variance of the one-period expected profit from holding stocks, namely

$$(7)\quad k = k(\mu, \sigma^2)$$

where

$$(8)\quad \mu = {}_{t}PSPOT^{e}_{t+1} - (1 + r_t + \psi)PSPOT_t$$

and σ^2 is the variance of the distribution of expected returns.[3]

We can rewrite (4) as:

$$(9)\quad PSPOT_t = \psi PSPOT_{t-1}$$

$$+ \beta f\left(\frac{(1+\omega+\gamma)USCON_t + USSPR_t + k(\mu_t, \sigma_t^2) + FSTCH_t - (DISRUP_t + USOIL_t + NONUSOPEC_t)}{CAPACITY_t}\right)$$

To analyze the effect on the spot price of a drawdown of U.S. strategic stocks, we can totally differentiate (9) to obtain:

$$(10)\quad dPSPOT_t = \frac{\beta f'}{CAPACITY_t}\left((1+\omega+\gamma)\left(\frac{\partial USCON}{\partial p_{us}}\,dp_{us} + \frac{\partial VSCON}{\partial y_{us}}\,dy_{us}\right) + dUSSPR_t\right.$$

$$\left. + k\mu(dPSPOT^e_{t+1} - (1+r_t+c_t)dPSPOT_t) + k\sigma^2\right).$$

The marginal acquisition cost of a barrel of oil in the U.S. differs from the spot market price of oil because of various market rigidities (including long-term contracts). We can think of the market-clearing U.S. price (in the absence of any government intervention in the form of tariffs or oil price controls) as adjusting to the spot price with a lag, i.e.,

(11) $P_{us,t} = a_0 + a_1 P_{us,t-1} + a_2\,(PSPOT_t - P_{us,t-1})$, so that

(12) $dp_{us,t} = a_2 dPSPOT_t$, and (10) becomes:

$$(13)\quad dPSPOT_t\left(\frac{1-\beta f'}{CAPACITY_t}\,\left(a_2(1+\omega+\gamma)\,\frac{\partial USCON}{\partial p_{us}} - k\mu(1+r_t+c_t)\right)\right.$$

$$= \frac{1-\beta f'}{CAPACITY_t}\,\left((1+\omega+\gamma)\,\frac{\partial USCON}{\partial p_{us}}\,dy_{us,t} + dUSSPR_t + k\mu dPSPOT^e_{t+1} + kod\sigma^2\right).$$

If the effect on oil prices induced by the change in strategic stock accumulation has only a negligible effect on real income, then (13) becomes:

$$(14)\quad dPSPOT_t\left(\frac{\beta 1-f'}{CAPACITY_t}\,\left(a_2(1+\omega+\gamma)\,\frac{\partial USCON}{\partial p_{us}} - k\mu\,(1+r+c)\right)\right.$$

$$= \frac{\beta 1-f'}{CAPACITY_t}\left(dUSSPR_t + k\mu dPSPOT^e_{t+1} + k\sigma^2 d\sigma^2\right), \text{ or,}$$

$$(15)\quad dPSPOT_t = \sum_{i=0}^{\infty}\left(\frac{k_\mu Q_t}{D_t}\right)^i\left(\frac{Q_{t+i}}{D_{t+i}}\right)dUSSPR_{t+i}$$

$$+\sum_{i=0}^{\infty}\left(\frac{k_{\sigma^2} Q_t}{D_t}\right)^i\left(\frac{Q_{t+i}}{D_{t+i}}\right)d\sigma^2_{t+i}\text{ , where}$$

(16) $Q_{t+i} = \frac{\beta f'}{CAPACITY_{t+i}}$, the spot price response to a required change in OPEC output, and

$$(17)\quad D_{t+i} = 1 - \frac{\beta f'}{CAPACITY_{t+i}}\left(a_2(1+\omega+\gamma)\frac{\partial USCON}{\partial P_{us}} - k\mu(1+r+c)\right),$$

the feedback, or general equilibrium, response of spot prices to induced changes in demand. The greater is the OPEC price response or the response of speculative inventory demand to expected profits, the larger is the effect of the SPR change on spot prices. The greater is the general equilibrium price response, the smaller will be the ultimate effect on spot prices on changes in SPR accumulation.

Implications for Drawdown Strategies

We are now in a position to examine the relative effectiveness of direct drawdowns of the SPR for spot market sales and guaranteed drawdowns next period (as per a futures market). Abstracting from effects on the variance of the distribution of expected future prices, the change in the spot price for a given drawdown today from the SPR is:

(18) $$\frac{dPSPOT_t}{d(-USSPR_t)} = \frac{-Q_t}{D_t} < 0.$$

Hence a contemporaneous drawdown of SPR oil will unambiguously reduce the spot price. The magnitude of the reduction depends on the two general equilibrium responses discussed earlier.

The effect on today's spot price of a drawdown next period announced today is:

(19) $$\left.\frac{dPSPOT_t}{d(-USSPR_{t+1})}\right|_t = \frac{k_\mu Q_t}{D_t} \; \frac{-Q_{t+1}}{D_{t+1}} < 0 .$$

If CAPACITY remains the same over the two periods (i.e., if the disruption gets "no worse" or "no better"), (19) could be rewritten as

(20) $$\left.\frac{dPSPOT_t}{d(-USSPR_{t+1})}\right|_t = -k_\mu\left(\frac{Q_t}{D_t}\right)^2.$$

Whether or not the guaranteed drawdown tomorrow decreases today's spot price more than a direct drawdown today is an empirical question. That is, it depends on the magnitudes of k_μ, Q_t, and D_t. For the delayed strategy to be absolutely superior in this respect, we require that:

(21) $$k_\mu D_t > Q_t,$$

that is, that

(21') (Response of speculative demand to expected profits) x (General equilibrium response of demand to the price change induced by the change in stockpiling policy) > (Response of spot price to changes in oil demand).

This is intuitively appealing, as it says that the announced drawdown tomorrow will be more effective in lowering today's spot price if: (a) the profit elasticity of speculative demand is high; (b) demand is fairly elastic with respect to price changes; or (c) spot prices do not respond completely to changes in the capacity utilization ratio in the same period (i.e., they depend on their own past values). Note that these conditions are similar to those found in the more general case in Section II.

To consider these results in the context of a futures market, we must complicate the situation. First, even in examining a "guaranteed drawdown" strategy, it is important to analyze the effects of the timing of refilling the reserve and the consequent impact on world oil prices. Second, the crude oil futures market may also have an effect on the variance of the distribution of expected future prices. To calculate the net relative effectiveness of the two strategies requires some knowledge of these other influences. Any empirical resolution of the issue must treat the feedback effects in the world oil market, the extent to which inventory behavior is forward looking, and the timing of any refilling of reserve stocks.

To examine the impact of a futures market in SPR oil on private inventory behavior and to compare the effectiveness in reducing oil prices of spot market sales and futures market sales, we will use simulations of an econometric model of the U.S. economy and the world oil market. The oil market model is the one described in Section III. The core macroeconomic model is discussed in detail in Hubbard and Fry [1982]. We have modeled optimizing private inventory behavior for the United States just as we described earlier in this section; a complete description may be found in Hubbard [1982].

To measure the costs of an oil supply disruption, we first simulate an undisrupted market from the fourth quarter of 1981 (1981:4) to the fourth quarter of 1985 (1985:4). In this "control" scenario, combined Iranian and Iraqi production recovers throughout the interval. U.S. oil production is projected to drop slowly throughout the interval, and production outside the U.S. and OPEC is expected to increase slowly and steadily.

The disruption which we simulate is one in which Saudi Arabian output is interrupted in calendar year 1983. Such a shock could arise from a blockade or an embargo. By 1984:1, Saudi Arabia ceases to be disrupted. The resulting price increase is not as large as not might guess because of increased production from nondisrupted OPEC members, the drop in consuming country demand (because of the higher prices), and the soft market at the onset of the disruption. Table 1 compares the paths of crude oil spot prices and U.S. private inventory accumulation across the two scenarios. The assumed accumulation pattern for the U.S. Strategic Petroleum Reserve is also given.

TABLE 1

Comparison of Control Scenario and Disruption Scenario

	Spot Price (\$/BBL)		Private Stock Change (1000 B/D)		SPR Fill (1000 B/D)	
	C	D	C	D	C	D
1981:4	31.70	31.70	520	520	350	350
1982:1	31.70	31.70	-640	-640	200	200
2	31.60	31.60	700	700	200	200
3	31.70	31.20	490	490	200	200
4	31.20	31.20	-670	-670	200	200
1983:1	30.60	36.80	-1080	-910	200	0
2	29.60	45.30	390	700	200	0
3	28.30	54.70	570	960	200	0
4	27.10	59.50	-470	-130	200	0
1984:1	26.20	51.90	-1250	-1180	200	200
2	26.00	45.10	190	370	200	200
3	26.90	39.40	480	580	200	200
4	28.50	35.20	-360	-480	200	200
1985:1	30.40	35.10	-1070	-1250	200	200
2	32.10	31.50	270	80	200	200
3	34.50	29.20	560	360	200	200
4	37.40	28.00	-230	-520	200	200

Two results from Table 1 are particularly interesting. First, spot prices rise fairly sharply after the onset of the disruption in 1983:1. (By the end of the solution interval, spot prices are actually lower in the disrupted scenario because of the large reductions in oil demand. The marginal cost of a barrel of oil to U.S. refineries is still slightly higher by 1985:4 in the disrupted scenario.) Second, private inventory behavior responds quickly to expected future profits. Inventory accumulation in 1983:2 - 1983:4 in the disrupted scenario ran almost 100 percent higher than in the base case. Stocks are decumulated relative to the control by the end of the interval, so that an inventory level equilibrium is restored.

We can now test the effectiveness of two SPR drawdown policies: (1) a spot market sale of 1,000,000 barrels per day during 1983:2, and (2) a sale of futures contracts in 1983:2 to sell 1,000,000 barrels of oil per day in 1983:3. To refill the depleted 90,000,000 barrels, we assume in both cases that the SPR fill rate after the disruption (i.e., in 1984 and 1985) will be 300,000 barrels per day instead of 200,000 barrels per day. Table 2 compares the effect on spot prices and on U.S. private inventory accumulation for the two strategies.

TABLE 2

Comparison of Spot Market and Futures Market Oil Sales

	Spot Price (\$/BBL)		U.S. Private Stock Change (1000 B/D)	
	Spot Sale	Futures Sale	Spot Sale	Futures Sale
1983:1	36.80	36.80	-910	-910
2	42.50	44.05	570	480
3	52.70	49.20	960	850
4	58.00	55.20	-120	-110
1984:1	51.10	49.30	-1180	-1170
2	44.70	43.30	370	350
3	39.00	38.10	570	570
4	35.40	34.60	-460	-480
1985:1	35.80	35.40	-1230	-1210
2	31.60	31.50	100	100
3	29.70	28.80	380	380
4	28.85	27.70	-570	-490

Comparing the results in Table 2 with those for the disrupted scenario (with no policy intervention) in Table 1, it is evident that both strategies influence spot prices and private inventory behavior. The size of the impacts is dependent upon the fact that policy changes are examined in a "U.S. only" analysis; that is, foreign inventory accumulation assumptions are held constant across scenarios.

Two interesting patterns surface. First, while the direct drawdown (spot market sale) of the SPR oil in 1983:2 lowered the spot price in that quarter, the sale of futures contracts in SPR oil for delivery in 1983:3 also lowered the spot price immediately. Moreover, under the futures sale option, spot prices remained slightly lower for the rest of the interval.

Second, the drawdown strategies blunted some of the extra private stockpiling which occurred because of the higher expected prices during the disruption. Comparing the private stockpiling trajectories in Table 2 reveals that part of the spot market sale was added to private stocks. By guaranteeing supplies to the market for 1983:3, the futures sale reduced private inventory accumulation during the disruption by more than the spot market sale. By 1985, both paths returned to that prevailing in the absence of policy intervention.

V. Conclusion

In this paper, we have attempted to make a case for drawing down the strategic petroleum reserve by selling futures contracts. The motivation behind this idea is the observation that, during oil supply disruptions, private inventories act in a manner to exacerbate the sharp rise in oil prices. We showed how sales of SPR futures, unlike other policy responses, dampen inventory demand by affecting expectations of future oil prices. Using a two-period model we identified conditions under which the sale of an equivalent amount of SPR oil in the spot and in the futures market would lead to a more favorable sequence of spot prices in the latter case. Our empirical analysis, based on a model of the world oil market and the U.S. economy, showed that futures sales (i) achieved much of the price-reducing benefits in the early stages of a disruption and (ii) led to a lower price trajectory overall when compared with spot market sales. Finally, we identified other possible advantages of SPR futures, which center mainly around the fact that futures contracts postpone, and in some cases avoid, the physical withdrawal of oil from the reserve.

It goes without saying that our results represent a first-pass at analyzing a new policy option for responding to a disruption in the oil market. Both our theoretical and empirical analyses can be extended to incorporate more features of the real world. Yet, we suspect the qualitative nature of our results will remain unchanged: selling futures contracts in SPR oil can be at least as effective in dampening spot market prices as a direct sale in the spot market.

On the other side of modelling and estimating these benefits, there remains the question of how such a scheme may be implemented. As there currently exists only a very thin futures market in crude oil, and as attempts to set up such a market in the past have met with limited success, the procedure by which the government could sell SPR futures contracts deserves considerable attention. Although we believe sales of SPR futures during a disruption are feasible, and in many ways easier to effect than spot market sales, we also feel that the success of such a policy depends on the amount of thought given to its implementation before the interruption occurs.

FOOTNOTES

[1] The background for such an approach is discussed in Hubbard and Fry [1982] and Nordhaus [1980].

[2] Income depends on the price of oil in a complex way because of the effects of changing oil prices on the trade balance; because of the ways in which changes in inflation may alter the real economy; and because of the impact of changing oil prices on potential economic performance (aggregate supply). A more complete discussion of these roles and a macroeconomic model underlying them are given in Hubbard and Fry [1982]. A discussion of appropriate functional forms (i.e., in terms of specification and lag structure) for the demand equations is also presented in that paper.

[3] r and c are the interest and physical carrying costs of inventories, respectively. (They are assumed to remain constant.) ${}_{t}PSPOT^{e}_{t+1}$ is today's expectation of next period's spot price.

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Department of Energy
Washington, D.C. 20585

March 8, 1983

MEMORANDUM FOR The Secretary

FROM: General Counsel

SUBJECT: Minimum Required Rate of Fill of the Strategic Petroleum Reserve (SPR)

You requested our opinion in response to the following two questions from Senator Jackson, both of which are based on the assumption that in fiscal year 1983 "there are sufficient funds available from FY 1983 appropriations or a continuing resolution plus the carryovers from FY 1982 (over $2 billion) such that the Department of Energy (DOE) could afford an average fill rate in excess of 220,000 b/d in FY 1983":

> "1. Doesn't Sec. 160(c)(1)(D) of EPCA, as amended by EEPA, require an SPR fill rate at the highest practicable rate achievable, subject to the availability of appropriated funds, notwithstanding the President's finding transmitted on December 1, 1982?"
>
> "2. Is the minimum required fill rate necessarily 220,000 b/d in that situation?"

In our opinion, the minimum required fill rate for the SPR in fiscal year 1983 is the highest practicable rate which can be achieved utilizing all available appropriations, after allowing for a carry-forward into fiscal year 1984 of funds to sustain purchases for the first six months of fiscal year 1984, even if the resulting fiscal year 1983 rate exceeds 220,000 barrels per day (b/d). Therefore, we believe the first question should be answered positively and the second negatively.

These issues involve the complex interplay of three statutory provisions: §160(c)(1) of the Energy Policy and Conservation Act (EPCA), Pub. L. 94-163, 42 U.S.C. §6234(c)(1), which recently was added by the Energy Emergency Preparedness Act (EEPA), Pub. L. 97-229; §167(b) of the EPCA, 42 U.S.C. §6247(b), which was added by the Omnibus Budget Reconciliation Act, Pub. L. 97-35; and the SPR petroleum appropriation contained in the Department of the Interior and Related Agencies Appropriations Act for fiscal year

1983, Pub. L. 97-394. The key provision, EPCA §160(c)(1), is flawed, ambiguous, and consequently subject to differing interpretations. We offer what we believe is the most plausible interpretation of the intent of the Congress.

In the discussion which follows we first set out the essential historical background of the fill requirements for the SPR and the legislative history of the minimum fill provisions imposed by the EEPA, and then provide our analysis of the issues raised by Senator Jackson's questions.

Historical Background

In §154(c)(1) of the EPCA, 42 U.S.C. §6234(c)(1), enacted in December 1975, the Congress adopted a schedule for fill of the SPR which was to be included in the SPR Plan and to be followed, "to the maximum extent possible and except to the extent that any change in the storage schedule is justified pursuant to subsection (e)(6)...." Subsection (e)(6) provides that the SPR Plan is to contain, "a justification for any changes, with respect to volumes or dates, proposed in the storage schedule...." The schedule set out in §154(c)(1) is expressed in terms of the periods of time within which the Government is to store amounts of crude oil equal to specified percentages of the crude oil imported during a base period, which was the three consecutive months during the 24 months preceding enactment of the EPCA in which average monthly imports were the highest.

The Federal Energy Administration, a predecessor agency to DOE, calculated that §154(c)(1) required fill to be accomplished on the following schedule:

Date	Million Barrels (MMB)
June 22, 1977	50
Dec. 22, 1978	150
Dec. 22, 1980	325
Dec. 22, 1982	500

Because the initial 1977 target had proved impossible to meet, the original SPR Plan transmitted to Congress in February 1977 by the Carter Administration dropped that requirement; the other three statutorily derived fill targets were incorporated into the Plan without change.

In Amendment No. 1 to the SPR Plan, submitted to the Congress in May 1977, the Carter Administration accelerated the SPR Plan's fill schedule as follows:

Date	MMB
June 22, 1978	250
Dec. 22, 1980	500

And in Amendment No. 2, transmitted to the Congress one year later, the Carter Administration further amended the SPR Plan to provide for storage by the end of 1985 of the full one billion barrels of crude oil authorized by the EPCA; the amendment detailed plans for the storage of 750 MMB of this billion, and said that with respect to the last 250 MMB, decisions had not yet been made about the type of storage facilities to be used or the extent of industry involvement (i.e., whether to mandate industry storage).

The fill schedule contained in the SPR Plan has not been further amended. Of course, the §154(c)(1) schedule does not impose any specific fill requirement by fiscal or calendar year.

In June 1980 the Congress enacted the Energy Security Act, Pub. L. 96-294, which added to §160 of the EPCA a new subsection (c) directing the President to assure that SPR fill was increased to an average rate of at least 100,000 b/d in each fiscal year commencing with fiscal year 1981; it further added a new subsection (d) effectively compelling a shut-in of Naval Petroleum Reserve No. 1 at Elk Hills, California, if this fill rate was not achieved.

In December of 1981 the Congress added to the 1981 Department of the Interior and Related Agencies Appropriations Act, Pub. L. 96-514, a requirement that the President "seek to" undertake SPR fill activities "at a level sufficient to assure" that crude storage is increased at an average annual rate of at least 300,000 b/d "or a sustained average annual daily rate of fill which would fully utilize appropriated funds."

Congress reenacted essentially the same 300,000 b/d "seek to" requirement in August 1981 in the Omnibus Budget Reconciliation Act, as an amendment to EPCA §160(c), but omitting the reference to a sustained average "which would fully utilize appropriated funds." The 300,000 b/d "seek to" requirement was made applicable until 750 MMB were in storage.

The Omnibus Budget Reconciliation Act also created the EPCA's §167 off-budget account for SPR oil purchases. Section 167(b) of the EPCA provides:

> (b) Amounts in the [SPR Petroleum] Account may be obligated by the Secretary of Energy for the acquisition, transportation, and injection of petroleum products into the Strategic Petroleum Reserve, and the drawdown and delivery of petroleum products from the Reserve--
>
> (1) in the case of fiscal year 1982, in an aggregate amount, not to exceed $3,900,000,000, as may be provided in advance in appropriation Acts;

> (2) in the case of any fiscal year after fiscal year 1982, subject to section 660 of the Department of Energy Organization Act,*/ in such aggregate amounts as may be appropriated in advance in appropriation Acts; and
>
> (3) in the case of any fiscal year, notwithstanding section 660 of the Department of Energy Organization Act, in an aggregate amount equal to the aggregate amount of the receipts to the United States from the sale of petroleum products in any drawdown and distribution of the Strategic Petroleum Reserve under section 161.
>
> Funds available to the Secretary of Energy for obligation under this subsection may remain available without fiscal year limitation.

On August 3, 1982, the EEPA was enacted. Among other things it superseded the Budget Reconciliation Act's 300,000 b/d "seek to" requirement by a new fill mandate. This was set forth as an amendment of §160(c) of the EPCA reading as follows:

> (c)(1)(A) The President shall immediately undertake, and thereafter continue, petroleum products acquisition, transportation, and injection activities, to the extent funds are available pursuant to section 167(b)(2) and (b)(3), at a level sufficient to assure that the petroleum products in the Strategic Petroleum Reserve will be increased at an average annual rate of at least the minimum required fill rate until the quantity of petroleum products stored within the Strategic Petroleum Reserve is at least 500,000,000 barrels.
>
> (B) Subject to subparagraph (C), the minimum required fill rate shall be 300,000 barrels per day for purposes of subparagraph (A), unless there is in effect a finding by the President in his discretion for good cause that compliance with such rate would not be in the national interest. Any finding by the President under this subparagraph takes effect on the date such finding is transmitted to the Congress and ceases to have effect at the end of the fiscal year

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*/ Section 660 of the Department of Energy Organization Act provides that "[A]ppropriations to carry out the provisions of this Act shall be subject to annual authorization."

in which such finding was made. Any such finding transmitted to the Congress shall include a statement of the facts upon which the finding is based. Any such finding shall not be subject to judicial review.

(C) The minimum required fill rate shall be 220,000 barrels per day for purposes of subparagraph (A) during the period in which any finding by the President under subparagraph (B) is in effect.

(D)(i) If funds are available in any given fiscal year after fiscal year 1982 to achieve an average annual fill rate higher than the minimum required fill rate in effect under subparagraph (C), the minimum required fill rate shall be the highest practicable fill rate achievable, subject to the availability of appropriated funds.

(ii) The Impoundment Control Act of 1974 (31 U.S.C. 1400 and following) shall apply to funds made available under section 167(b) and (e).

(2) After the Strategic Petroleum Reserve reaches a level of 500,000,000 barrels, the President shall immediately seek to undertake, and thereafter continue, petroleum products acquisition, transportation, and injection activities at a level sufficient to assure that the petroleum products in the Strategic Petroleum Reserve will be increased at an average annual rate of at least 300,000 barrels per day until the quantity of petroleum products stored within the Strategic Petroleum Reserve is at least 750,000,000 barrels.

Legislative History of the EEPA

The bill reported by the Senate Committee on Energy and Natural Resources and passed by the Senate, S. 2332, would have amended EPCA §160(c) to direct the President, subject to the availability of funding "pursuant to section 167(b)(2)" of the EPCA, to increase SPR fill at an average annual rate of at least 300,000 b/d until 500 MMB was in storage. Section 167(b)(2), quoted above, limits the obligation of funds from the off-budget SPR Petroleum Account "in the case of any fiscal year after fiscal year 1982" to "such aggregate amounts as may be appropriated in advance in appropriations acts." The "pursuant to section 167(b)(2)" language had not appeared in the bill considered by the Committee or in any proposed amendment thereto; it first appeared with publication of S. Rep. 97-393. In the floor debate, Committee Chairman McClure described the 300,000 b/d mandate simply as being "subject to available appropriations", without noting that the bill referred specifically only to appropriations available pursuant to §167(b)(2).*/

The bill reported by the House Committee on Energy and Commerce, H.R. 6337, in its proposed amendment to EPCA §160(c), required an average annual fill rate of at least 200,000 b/d (and a rate of 300,000 b/d when the President considered this "fiscally prudent"), until storage reached the 500 MMB level. No reference was made to available appropriations. The Committee Report took note of the fact that previous "seek to" language had not had the effect desired by Congress; the new "fiscally prudent" language was characterized as an attempt to set a "specific standard" as opposed to the former "general terms"; the "seek to" requirement was reaffirmed "as a goal", and as the "expressed goal and resolve of Congress that DOE achieve" the 300,000 b/d rate. H.R. Rep. 97-585 at 6-7. During House passage Subcommittee Chairman Sharp, floor leader for the bill, stated that the bill continues the requirement that the Administration "seek to" fill at 300,000 b/d. 128 Cong. Rec. H.3860 (June 23, 1982).

The bill reported by the conferees, which was enacted into law, is substantially different from both the Senate and House bills. The Conference Report advised as follows with respect to the fill rate:

> Section 4(a) amends section 160(c)(1) of EPCA to require the President to fill the SPR at an average annual rate of at least the minimum required fill rate until 500 million barrels are in storage. The minimum required fill rate will be determined in one of three ways.
>
> Subparagraph (B) establishes the minimum required fill rate of 300,000 barrels per day. Under this subparagraph, the President may make a finding that compliance with the 300,000 barrel per day rate would not be in the national interest for good cause. For instance, the President may find that:
>
> (i) compliance with such rate significantly impairs the ability of the United States to respond to a severe energy supply interruption;

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*/ Because §167(b)(2) refers only to fiscal years after fiscal year 1982, as distinguished from §167(b)(1), which refers only to fiscal year 1982, it may be argued that by this distinction the Congress intended that fill rates after fiscal year 1982 be calculated only on the basis of appropriations made for fiscal year 1983 and succeeding years, without regard for unexpended balances or advance-funded deliveries carried over from fiscal year 1982. We explain below why we believe this would not be a valid reading of §160(c).

> (ii) compliance significantly impairs the ability of the United States to meet its obligations under the international energy program; or
>
> (iii) compliance is inappropriate due to economic conditions affecting the general welfare.
>
> If he makes such a finding and transmits it to Congress, accompanied by a statement of the facts upon which the finding is based, the minimum required fill rate shall be 220,000 barrels per day, as required by subparagraph (C).
>
> Subparagraph (D) establishes the minimum required fill rate that would be in effect where funds are available in any given fiscal year after fiscal year 1982 to achieve an average annual fill rate higher than the minimum required fill rate in effect under subparagraph (C). In such cases, the minimum required fill rate shall be the highest practicable fill rate achievable subject to the availability of appropriated funds.
>
> Appropriation Acts will necessarily govern the availability of funds. The purpose of subparagraph (D) is to express the policy that the President shall fill the SPR at the highest practicable fill rate achievable subject to the availability of funds. (H.R. Rep. 97-663 at 12)

During House floor action on the Conference Report, Chairman Sharp described the bill as requiring that, after a Presidential finding not to fill at the 300,000 b/d level, the SPR be filled at a rate of at least 220,000 b/d "unless funds available through the appropriations process make it practicable to achieve a higher fill rate." 128 Cong. Rec. H.4921 (July 30, 1982).

The statement of Chairman McClure, inserted into the record by Senator Warner, said that after the Presidential finding, "the minimum required fill rate would be either 220,000 barrels per day, or, if funds are available to achieve a higher rate, the highest practicable fill rate achievable with available funds." Senator McClure's statement later reiterated this (as did Senator Warner in his own statement), adding, "Thus, appropriations acts will necessarily govern the availability of funds." 128 Cong. Rec. S. 9481, 9485, 9486 (July 30, 1982).

Senator Jackson, ranking Minority Member of the Senate Energy and Natural Resources Committee, had a somewhat more particularized understanding of what the bill's fill provisions meant. Referring to what he described as a new §160(c)(1)(D)(i) requirement to fill at the highest practicable rate "given available funds", he said:

The intent of the Congress on this point cannot be overemphasized. The use of the terms "If funds are available..." and "subject to the availability of appropriated funds" are intended in this provision to refer to any funds available to the SPR after fiscal year 1982, including fiscal year 1982 carryovers. This provision is the mechanism by which the Congress requires the President to spend any funds that are available to him in a given fiscal year to fill the SPR at the highest practicable average rate in that fiscal year.

* * * *

The mandate to fill at a minimum of 300,000 (or 220,000) barrels per day as the case may be, and the mandate to fill at the highest practicable fill rate are intended to be regarded as program objectives for the strategic petroleum reserve program. The intention is that if the President has available the necessary funds to achieve a mandated fill rate, then he must comply with that mandate or seek and obtain a deferral or rescission of the available funds under section 1012 or 1013 of the Impoundment Control Act. The only exception is if the President obtains suspension of the mandates through section 160(e) of EPCA.*/

* * * *

The Presidential finding that reduces the mandated minimum fill rate from 300,000 barrels per day to 220,000 barrels per day is subordinate to the requirement to fill at the highest practicable rate. Even though the President makes such a finding, he is still required to fill at the highest practicable rate. This is not a contradiction because there is another provision in section 160(e) of EPCA in existing law which enables the President to seek a suspension of the requirements in section 160(c) including the requirement to fill the SPR at the highest practicable rate. In that case, the Congress must enact a two-House resolution approving the suspension of the requirement. If the President is not willing to afford Congress the opportunity for its review and disapproval, then the requirement to fill at the highest practicable rate remains.

Another important point to note is the meaning of the term "practicable" in section 160(a)(1)(D)(i). The intention here is that the term "practicable" means what we normally think that word means--feasible.

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*/ This suspension provision applies if the President has found that compliance impairs U.S. ability to respond to a severe energy supply interruption or to meet U.S. obligations under the Agreement on an International Energy Program.

> Therefore, the SPR must be filled in a given fiscal year at the highest feasible rate averaged over that fiscal year given available funds from whatever source. (128 Cong. Rec. at S. 9488)

Presidential Finding

On December 1, 1982, the President, pursuant to EPCA §160(c)(1)(B) as amended by EEPA §4(a), transmitted to the Congress his finding that it would not be in the national interest to fill the SPR at the rate of 300,000 b/d during fiscal year 1983.

Discussion of Issues

Section 160(c)(1)(D) of the EPCA, as amended by the EEPA, provides that if available appropriations permit achievement of an average annual SPR fill rate higher than 220,000 b/d, the minimum required fill rate for that fiscal year shall be the highest practicable rate which can be achieved, utilizing those funds. In determining whether an average annual fill rate in excess of 220,000 b/d is achievable in fiscal year 1983, the basic question is what funds are "available" for this purpose. More precisely, did the Congress intend that in fiscal year 1983 only funds appropriated for that year were to be "available" for calculating the fill rate? Or did it intend that funds or funding authority carried over from fiscal year 1982 were to be included in the calculation? If so, what funds or funding authority carried over from fiscal year 1982 are to be included - only funds unobligated by DOE at the end of fiscal year 1982? Or, in addition, funds obligated by DOE by transfer to the SPR procurement in the Department of Defense but not yet placed in purchase contracts by the end of fiscal year 1982? Or, in addition, funds paid in advance in fiscal year 1982 for oil to be delivered in fiscal year 1983?

For the reasons to be set forth, it is our opinion that the Congress intended to be included in the calculation of the achievable fill rate in fiscal year 1983 all the funding authority that can practicably result in delivery of oil to the SPR in fiscal year 1983, except for funds to buy oil for delivery in the first six months of fiscal year 1984 at the lowest required rate (220,000 b/d).

In answering the question what funds are "available" for determining the fill rate in fiscal year 1983, we must look first to the words of the statute. Section 160(c)(1)(D) is one of four subparagraphs, the first of which, §160(c)(1)(A), authorizes and directs the President to fill the SPR "at an average annual rate of at least the minimum required fill rate" until 500,000,000 barrels of oil are stored in the SPR.*/ The subsequent three subparagraphs each define the "minimum required fill rate" under different circumstances. Subparagraph (B) says it is 300,000 b/d "for purposes of subparagraph (A)" in the absence of a Presidential finding that such a rate would not be in the national interest. Subparagraph (C) says it is 220,000 b/d "for purposes of subparagraph (A)" during any period such a Presidential finding is in effect. Subparagraph (D) says it is the "highest practicable fill rate achievable" if funds are available in any fiscal year after fiscal year 1982 to achieve a rate higher than 220,000 b/d.

However, subparagraph (D) does not contain the words "for purposes of subparagraph A" as subparagraphs (B) and (C) do, and we must ask whether by this omission the Congress intended a different interpretation to be given to (D) than to (B) or (C), for purposes of identifying what funds are available for determining the fill rate. That interpretation would be that the availability of funds under subparagraph (D) is not subject to whatever limitation on availability is imposed by subparagraphs (B) or (C) but rather is governed only by the more general limitation, stated in (D), of being "subject to the availability of appropriated funds." Subparagraph (A), which imposes the requirement to fill the SPR at the minimum required fill rate, does so only "to the extent funds are available pursuant to section 167(b)(2) and (b)(3)." As indicated above, §167(b)(2), in authorizing the off-budget SPR account, authorizes the Secretary of Energy to obligate funds for filling the SPR "in the case of any fiscal year after fiscal year 1982...in such aggregate amounts as may be appropriated in advance in appropriations Acts."**/

The use of the plural - "appropriations Acts" - at least strongly suggests that the Congress did not intend that in 1983 only the funds appropriated in the appropriations Act (singular) for fiscal year 1983 were to be available for calculating the fill rate for that year. Rather, it at least strongly suggests that as in fiscal years later than 1983, funds appropriated in advance in prior years' appropriations Acts, e.g., that for fiscal year 1982, were also to be available for this purpose. This view is supported by the fact that Congress made all funds under §167, including the $3.9 billion in the case of fiscal year 1982, available for obligation "without fiscal year limitation."

Thus, we believe that either way §160(c)(1)(D) is read - whether it is subject to funds available under §167(b)(2) or whether it is subject only to funds made available under any appropriation for this purpose - the result in practical terms is the same: in fiscal year 1983, the fill rate calculation is to include funds available from prior years' appropriations Acts, i.e., specifically the appropriations Act for fiscal year 1982.

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*/ As of March 7, 1983, 307,700,000 barrels have been stored in in the SPR.

**/ Section 167(b)(3) provides authority for restoring the SPR after a drawdown and is irrelevant to this discussion.

The legislative history of EEPA's amendment of EPCA's §160(c) clearly indicates that the amendment was a compromise between a 200,000 b/d House of Representatives fill rate requirement and a 300,000 b/d Senate requirement and further that the actual fill rate was to be determined in the appropriations process. The Chairmen of the relevant authorizing Committees of the House and Senate (quoted above at page 7) both emphasized, in explaining the Conference Report, that as stated in the Conference Report itself, "Appropriations Acts will necessarily govern the availability of funds." H.R. Rep. No. 97-663, 97th Cong. 2d Sess. 12 (1982) We find that in the appropriations process, both Houses of Congress acted on the assumption that funds available from fiscal year 1982 would be used in calculating the fill rate in fiscal year 1983, as well as funds appropriated just for that year. This is significant, for it reflects a contemporaneous construction of the statute by the same Congress - and many of the same Senators in particular - that enacted it.

The Department of the Interior and Related Agencies Appropriations Act for fiscal year 1983 provides:

> The aggregate amount that may be obligated under section 167 of the Energy Policy and Conservation Act (Public Law 94-163), as amended by the Omnibus Budget Reconciliation Act of 1981 (Public Law 97-35), for the acquisition and transportation of petroleum, and for other necessary expenses is $2,074,060,000, in addition to authority provided for fiscal year 1982, to remain available until expended. (Emphasis added)

This language was proposed by the Administration and was adopted without change by both Houses of Congress. The phrase "in addition to authority provided for fiscal year 1982" was not inadvertent. Indeed, it was essential. If it had not been inserted, the amount that could be obligated under the remaining language would have been limited to $2,074,060,000. Any funds remaining unobligated from 1982 would thereby have become unavailable for obligation after 1982, even though they were originally appropriated to remain available until expended.

In reporting H.R. 7356, which became the fiscal year 1983 Interior Department appropriations act, the House Appropriations Committee indicated its belief that "a fill rate of at least 220,000 barrels per day is possible within the budget request because of lower than expected oil prices." H.R. Rep. 97-942 at 106. Clearly, there was no expectation that this could be accomplished exclusively with fiscal year 1983 appropriations, without using funds carried over from 1982.*/ And the Senate contemplated a fill rate entailing even greater reliance upon carry-over funding in 1983. In its Explanatory Statement of Recommendations (made in lieu of a report), the Senate Appropriations Committee noted that the SPR petroleum funds appropriated by H.R. 7356, when combined with funds carried over from fiscal year 1982, "would enable the President to achieve a rate of fill for the SPR in fiscal year 1983 that is significantly higher than 220,000 barrels per day"; it opined that the EEPA "establishes this 'achievable' fill rate as the required minimum fill rate." The Committee further stated that:

> In light of questions of national defense as well as the currently soft oil market and the requirements of section 160(c)(1)(D) of the Energy Policy and Conservation Act, the Committee cannot be satisfied to maintain the minimum fill of 220,000 barrels per day. Accordingly, the Department is directed to take the steps necessary to purchase additional petroleum in order to take advantage of favorable market conditions and to provide interim storage facilities, if necessary, for such additional purchases. (128 Cong. Rec. S. 14277, 14299 (December 9, 1982))

Nowhere in the appropriations process does one find even a hint that the SPR's fiscal year 1983 minimum required fill rate should be calculated in disregard of ongoing deliveries and actual cumulative funding levels, on the basis of some artificial formula.

The next question is precisely what funds from fiscal year 1982 are available for the calculation. At the end of fiscal year 1982 $2,403,000,000 of oil acquisition funds were uncosted, consisting of $307,000,000 unobligated by DOE and $2,096,000,000, which had been obligated either by transfer to the Department's SPR purchasing agent, the Defense Fuel Supply Center (DFSC), but not yet committed to contracts for delivery of oil or directly to oil supply contracts, such as DOE agreements with PEMEX, for oil to be delivered in fiscal year 1983. In our opinion, all these funds are "available" for making the fill rate calculation. Obviously, the fill rate of 220,000 b/d is calculated taking into account deliveries made in fiscal year 1983 even if funded in advance in fiscal year 1982. There is equally no reason to exclude funds remaining to be committed to contracts for delivery in fiscal year 1983, even though technically they are obligated by the Department of Energy when transferred to DFSC.*/ To consider only fiscal year funds remaining unobligated at the Department of Energy as available for the calculation of fill rate would be to create an artificial calculation, divorced from all reality, and nowhere hinted at in the legislative history.

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* In fact, the appropriation for fiscal year 1983, $2,074,060,000, would not permit this fill rate, together with a continuation of it for six months in fiscal year 1983, as contemplated by the House Appropriations Committee, unless carryover funds from fiscal year 1982 were considered available for the calculation of the fill rate.

Congress enacted the EEPA with knowledge that oil was being contracted for in one fiscal year for delivery in the next, and that all unexpended fiscal year 1982 appropriations would be carried over to fiscal year 1983; it assumed that those unexpended appropriations would be used. Congress passed the Interior Appropriations Act with the additional knowledge that much oil to be delivered in fiscal year 1983 had been paid for in 1982. By its appropriation the Congress reaffirmed its intention that the previously enacted appropriations be available for use in fiscal year 1983. The pledge of SPR funds to DFSC, while legally sufficient for their obligation, is merely an understanding between two government agencies, one step removed from the actual procurement and storage of oil. Congress was, of course, concerned about the procurement and storage of oil when it passed the EEPA and the Interior appropriations act.

To treat funds obligated by DOE to DFSC as though they were unavailable to achieve the Congressional intent of maximizing the SPR's fill rate simply would exhalt form (the niceties of the law governing obligation of funds between two agencies within the Executive branch) over substance (the Congressionally imposed requirement that appropriations be used to purchase and store oil). There is absolutely nothing in the legislative history of either law which lends any support to so artificial and unrealistic a calculation.

We believe that under the law, the minimum required fill rate for the SPR in fiscal year 1983 is the highest rate, up to a ceiling of 300,000 b/d, which it is practicable to achieve utilizing all available obligated or unobligated appropriations that can result in deliveries during 1983, but allowing, as we shall see, for purchases for delivery during the first six months of fiscal year 1984. This total amount will vary, of course, as oil prices fluctuate.

It remains to consider, however, what is or is not "practicable", within the sense of the law. The EPCA's §160(c)(1)(D)(i) requirement for SPR fill at "the highest practicable fill rate achievable" was adopted by the EEPA conferees, who provided little guidance as to its meaning. The statute therefore leaves it open to the President to make a reasonable judgment as to what the "highest practicable" fill rate is. In doing so he is not limited to considering how much oil DOE could "afford", as Senator Jackson's questions seem to assume. Had Congress intended this restriction, it could have imposed the fill requirement more straightforwardly without conditioning the fill rate upon its being "practicable" and "achievable." These modifiers suggest that Herculean and desperate measures to fill the SPR at any cost are not necessary, and that other programmatic requirements need not be ignored. The achievability of any theoretical "highest" fill rate must be considered in light of the facts that the new storage requirement was first established, for fiscal year 1983, three months after this fiscal year began, and that it may entail a substantial facilities and oil procurement effort.

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*/ This was acknowledged by the Comptroller General in ruling that funds so "obligated" do not lapse at the end of a fiscal year during a time when SPR appropriations were limited to one year. Comptroller General Letter Decision (B-193005), "Obligation of Funds for Purchase of Oil for Strategic Petroleum Reserve" (October 2, 1978).

Moreover, the President properly may take into account any programmatic requirements which are not compatible with maximizing SPR fill in a given fiscal year. These may include the accepted need to enter the ensuing fiscal year with sufficient remaining appropriations to fund SPR purchases for six months, as well as making short-term adjustments in the pace of oil acquisition so as to take advantage of crude oil market trends. Prior to the enactment of the EEPA the SPR program had established a practice of carrying forward into the following year funds for six months of oil procurement, to assure the continuity of leach/fill operations, fund long-term oil purchase contracts, and serve programmatic planning objectives. The Congress enacted the EEPA with knowledge of this practice.

In reporting H.R. 7356, which was enacted as the fiscal year 1983 Department of the Interior and Related Agencies Appropriations Act, the House Appropriations Committee indicated its belief that "a fill rate of at least 220,000 barrels per day is possible within the budget request because of lower than expected oil prices", and stated that at this rate:

> At the end of fiscal year 1983, there would be undelivered orders of 39,000,000 barrels, nearly enough to cover delivery for the first six months of fiscal year 1984. Because of the lead time required, the managers of the program believe it is important to have six months of fill on order. (H.R. Rep. 97-942 at 106) (Emphasis added)

Although the Senate favored a higher 1983 fill rate than did the House, the Senate never explicitly challenged the SPR program's practice of advance funding for six months of purchases, utilizing no-year appropriations. Like the House, the Senate accepted the President's budget proposal, which was premised upon a carry-forward into 1984 of funding for six months of oil purchases.

Indeed, this is a well established practice, serving valid programmatic objectives, of which Congress was aware when it enacted the EEPA. Yet neither the EEPA nor the 1983 Interior appropriations act altered the nature of the available funds or the advance funding practice. It is well established that when the Congress, having specific knowledge of an administrative interpretation by the department charged with responsibility for administering a statute, appropriates funds for the activities under that statute, it confirms the department's construction of the statute and ratifies its actions. See Brooks v. Dewar, 313 U.S. 354, 360-61 (1941); Isbrandtsen-Moller Co. v. United States, 300 U.S. 139, 146-47 (1937); 2A Sands, Sutherland on Statutory Construction §49.10 (4th ed. 1973). See also Udall v. Tallman, 380 U.S. 1, 17-18 (1965); Air Line Stewards, Etc., Ass'n v. Northwest Airlines, Inc., 267 F.2d 170, 174 (8th Cir. 1959).

Concluding that a six month carry-forward of appropriations in fiscal year 1984 is authorized, it is necessary to determine what rate of fill during the first six months of 1984 should be assumed for this purpose. The President's proposed budget is for a fill rate of 145,000 b/d. However, this reduced rate is subject to Congressional approval, and in the interim one must look for guidance to the provisions of EPCA §160(c)(1), as amended by the EEPA. Under §160(c)(1)(B), the minimum required fill rate during 1984 is to be 300,000 b/d, unless there is in effect a Presidential finding for good cause that compliance with such rate would not be in the national interest. A comparable finding was made for fiscal year 1983, and the President's budget for 1984 gives every reason to expect that this finding will be made again next year. If it is made, §160(c)(1)(C) provides that the minimum required fill rate shall be 220,000 b/d. Therefore, until the Congress has acted favorably upon the President's budget request for 1984 SPR oil fill, it seems reasonable to assume a 220,000 b/d fill rate for fiscal year 1984, when reserving appropriated funds to be carried forward into that year.

Additional justification for carrying forward fiscal 1983 funds for obligation or for deliveries in fiscal year 1984 may be found in EPCA §160(b), which provides:

> The Secretary shall, to the greatest extent practicable, acquire petroleum products for the Reserve...in a manner consonant with the following objectives:
>
> (1) minimization of the cost of the Reserve;
>
> (2) orderly development of the Naval Petroleum Reserves to the extent authorized by law;
>
> (3) minimization of the Nation's vulnerability to a severe energy supply interruption;

(4) minimization of the impact of such acquisition upon supply levels and market forces; and

(5) encouragement of competition in the petroleum industry.

Note that this provision is currently effective, whereas the Energy Security Act in 1980 had imposed its 100,000 b/d minimum fill requirement "notwithstanding subsection (b)." It is conceivable that in some circumstances compliance with the §160(b) objectives may be inconsistent with filling the SPR at a rate that would exhaust available appropriations by the end of the fiscal year.

Moreover, we do not believe §160 reasonably can be construed as mandating, under any circumstances, a fill rate in excess of 300,000 b/d. The §160(c)(1)(D)(i) requirement for SPR fill at the "highest practicable" rate only comes into play if a "minimum required fill rate" of 220,000 b/d under §160(c)(1) has become applicable because of a Presidential finding, under §160(c)(B), that a fill rate of 300,000 b/d "would not be in the national interest." Under those circumstances, it would be anomalous if the effect was not only to nullify the President's finding, but also to impose a requirement of an even greater fill rate. Had this been the intent of Congress, it easily could have so specified.

On the other hand, the "highest practicable" mandate clearly does require a good faith effort to use the available appropriations to maximize the SPR's average fiscal year 1983 fill rate, so long as this increased fill is reconcilable with the SPR's other programmatic and statutory requirements; of course, if oil prices change significantly during the course of a fiscal year the fill mandate may change accordingly. But absent a deferral or a rescission, it would not be appropriate to defer SPR fill solely in order to reduce the obligation or outlay of available appropriations in the current fiscal year.

Likewise, limitations in unfilled permanent storage capacity provide no justification for failing to utilize available appropriations in the current year. In the EEPA, the Congress amended the EPCA to make clear that an absence of permanent storage capacity is not a valid basis upon which the SPR's fill rate can be determined. As amended by the EEPA, the EPCA makes petroleum stored in "interim" facilities a part of the SPR (§159(b)(2), 42 U.S.C. §6239(h)(2)); eliminates any requirement for amending the SPR Plan to identify the interim facilities or for preparing an environmental impact statement before storing oil there (§159(h)(1),(3), 42 U.S.C. §6239(h)(1),(3)); makes the SPR program's basic statutory authorities available with respect to interim storage activities (§159(f)(5), 42 U.S.C. §6239(f)); and allows funds to be obligated from the SPR's off-budget account to pay for interim storage expenses (§157(e), 42 U.S.C. §6247(e)).

Our conclusion, that the "maximum practicable" mandate of EPCA §160(c)(1)(D)(i) is not constrained at the 220,000 b/d level, is supported not only by the language of the statute, but also by the history of the SPR fill schedule and of the EEPA's enactment. The SPR remains behind the fill schedule established in the SPR Plan, and a reading of the legislative history of the EEPA as a whole demonstrates a clear intent that SPR oil fill be accelerated. The EEPA does not direct the President to rush pell-mell into facilities and oil acquisition in disregard of other programmatic or statutory requirements or of prudent standards of care but, subject to assuring a continuity of program funding into the next fiscal year, it does compel a conscientious effort to utilize all available appropriations (including advance-funded deliveries) so as to maximize the rate of fill in the current fiscal year.

R. Tenney Johnson

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